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A PRODUCTIVITY GUIDE FOR MANUFACTURING MANAGEMENT

Richard L. Hapgood

SALES-ORIENTED OVERHEAD COSTING

David H. Li

ESSENTIALS OF CORPORATE PLANNING

Frank S. Capon

WINNING TAX SAVINGS FROM BAD DEBTS

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Correspondence

READER AND AUTHOR LOOK AT PROFITABILITY MEASUREMENTS

Editors, THE CONTROLLER:

It is my wish to defend the discounted-cash-flow method from the attack made upon it in "The Manager Looks at Profitability Measurements" by W. B. Thulin in the February issue of THE CONTROLLER.

As I read the article, it attacks the discounted-cash-flow technique on the basis that the "depreciation contour" mathematically produced by the DCF method is not necessarily consistent with depreciation theory as applied by accountants. It is pointed out that the DCF calculation can be thought of as separating each year's cash in-flow into earnings and return of capital. The point is made that in the accounting field the adoption of the principle of "continuous depreciation unrelated to profits" took many years to crystallize. The DCF method is then criticized on the basis that it necessarily relates depreciation to profits. The conclusion is that by accepting the DCF answer, the analyst also is accepting a depreciation contour that may be at odds with ordinary accounting approaches.

I think that this argument generates from an unfortunate confusion of the principles of investment analysis with the somewhat different principles and practices of accounting.

It must be recognized that the fundamental aim of the investment analyst is to *forecast the future;* whereas that of the accountant is to present as fair, accurate and consistent a *record of the past* as is possible. Every businessman becomes an investment analyst whenever he considers the price he should pay for a piece of equipment, a building, or other fixed asset, or for a stock or other security—in short, for *any income-producing asset.* He will, of course, pay as little as necessary, but the top price he is willing to pay is one which is not out of line with the *future earning power* of the asset. In theory, he will pay no more than the present value of future income. The best-developed techniques for practical asset evaluation probably are those of stock market analysts. This fraternity has for decades related stock values and asset worth to earning capacity rather than to any other measure, including book value. It is hard to imagine any freely traded commodity or business property whose value is not ultimately related to income potential.

But if business asset values are so widely considered to be based upon earning power, why does the accountant not follow suit? Part of the answer is that valuation on the basis of earning power requires at least an implicit forecast of future earnings from the asset. Accounting ideology will not allow this.

The accountant would nevertheless *like* the asset values and value changes reflected by his statements to be as consistent as possible with those which the business world would consider realistic. His aim is to charge against income for a given period the reduction in asset value which has taken place. Ideally, the accountant would be able to ascertain the "true" business value of each asset at the beginning and end of each accounting period.

However, there is no practical way of accomplishing these ends in a manner applicable to all assets and to all companies. The time required would be great; attempts to establish actual market values would not be feasible; and difficulty of differentiating the earnings of a particular asset from the over-all profits of the company would be a major stumbling block. To estimate a group depreciation rate for several assets upon over-all company or division profits (past or present) would necessitate an unrealistic

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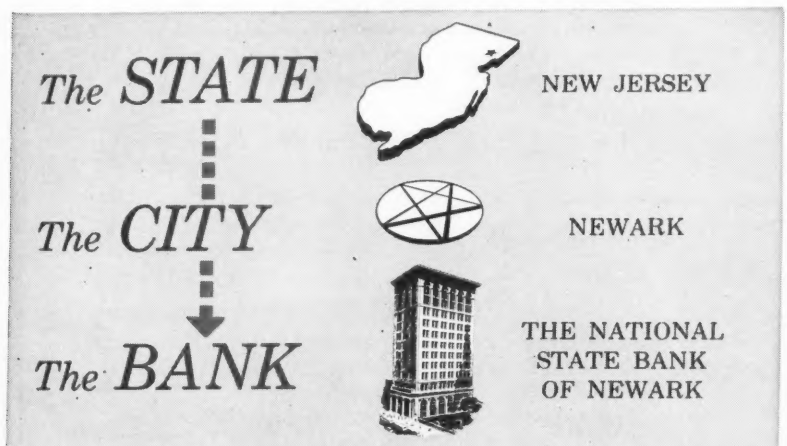
DO YOU AGREE or do you disagree with an article in this month's issue? Your fellow readers will be interested. Naturally, letters to the editor must bear the writer's signature and address; these will be withheld on request. The Editors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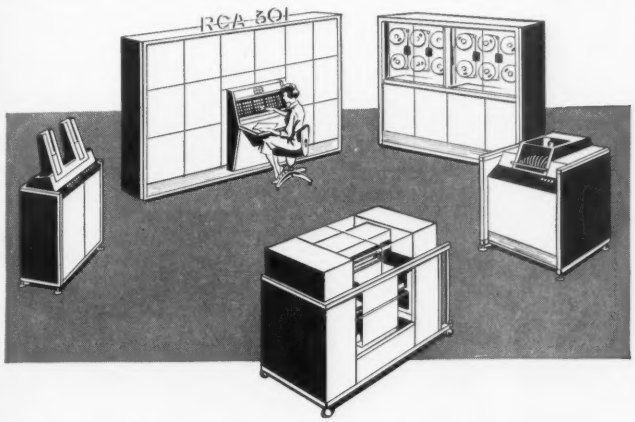

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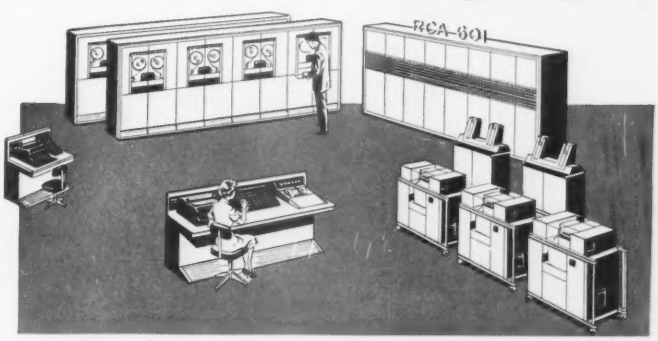

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assumption that profits for a given period were tied solely to asset performance or value, thus excluding consideration of management performance, market fluctuations, under-capacity operation, and other factors. Therefore, in the interests of practicality and consistency, the accountant writes off assets without regard for past or anticipated profits. Most will agree, however, that although the various depreciation methods are designed with sound theory in mind, they are little more than arbitrary ways of approximation.

The principle of "depreciation unrelated to profits" as well as the commonly used depreciation methods themselves are thus a part of the generally accepted practice of accounting, rather than a part of the accounting theory that is concerned with the ideal, or with pure theoretical considerations. Neither the principle nor the depreciation methods would be adopted by a businessman drawing up a "perfect" accounting system. "Depreciation" would be looked upon as a revaluing process rather than an allocation of original cost.

The point is that the investment analyst does not work under the same circumstances as does the accountant. As a forecaster of the future, rather than a recorder of the past, he need not be arbitrarily shackled by the same principles. The investment analyst needs be concerned only with the pure theory of return of capital, rather than with the *practical accounting* application of depreciation. He can employ an "ideal" method of accounting, which relates asset value only to profit potential of the asset. Because he *must* forecast profits, he automatically forecasts asset values.

This line of reasoning is not in disagreement with the article's contention that the analyst should "establish an appropriate depreciation contour." This the analyst does automatically through use of the discounted-cash-flow method. The DCF technique values assets on the basis of earnings power, since by definition the "undepreciated" value is always generating the same rate of return. In stock market language, the assets are valued continuously on the basis of the same price-earnings ratio. Illustrations in the article under discussion serve to demonstrate this point. Table D shows that for a specific project, evaluated by DCF, assets earning $500 in year 1 are valued at twice earnings or $1,000; and that the same assets, when earning $300 in year 2, are consistently valued at twice earnings, or $600. However, in Table E, which embodies a substitute approach suggested by the author, the accountant has valued the assets at 2½ times earnings in one year and 1¼ of earnings in the second year. Clearly, the second method does not value the assets on any consistent earnings basis. Far from ". . . abdicating his responsibility for determining the depreciation contour which should apply . . .," the analyst, in using the DCF approach, automatically handles depreciation so as to achieve a result which accounting theoreticians have hoped for for several hundred years!

Most analysts are not concerned by the fact that the DCF method uses a valuation rate (i.e., price-earnings ratio or capitalization rate) which differs from project to project depending on a project's own rate of return. They point out that projects showing better than acceptable rates of return will value assets conservatively; assets will be over-valued only in the case of projects which are rejected anyway.

The actual way in which the accountant will depreciate a given asset is important to the capital investment analyst only as it affects income taxes, and therefore the cash flow. This should be true even in public utilities, where management feels perpetual pressure from governmental rate-setting agencies whose examination criteria give heavy consideration to accounting for depreciation.

The "composite earnings-yield method" has the following drawbacks:

1. It replaces generally accepted principles of investment analysis with the arbitrary and unrealistic methods used (of necessity) by accountants for setting depreciation schedules;

2. It asks the accountant to do what he does not and cannot do—make forecasts, based partly on his own judgment, of the saleable or useful value of assets in the future;

3. Even accepting the aims of the method, I am not sure these aims are achieved. Generally, predicted rates of return for discretionary investments are not acceptable unless they are substantially higher than the actual average rate of return for the company as a whole. (Allowance must be made for risk and for low-profit "necessary" investments.) The rate of earnings assumed for the "depreciation reserve" in this method should in most cases be the rate which will be predictable for discretionary investments (or the "cut-off"), rather than the actual average company return. In most cases, use of this higher rate will greatly reduce the difference between results from this method and from the DCF technique;

4. Considerable calculation is involved.

At the same time, the article does spotlight a real weakness in the DCF approach when it expresses doubt about DCF treatment of projects of different life expectancy. However, for reasons too complex to discuss in a letter, and on the basis of our experience as management consultants, I feel that this is more a

(Continued on page 204)

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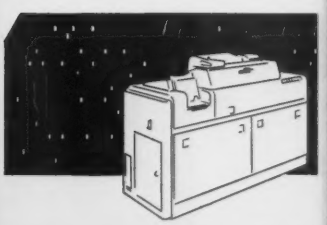

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theoretical flaw than an actual one and that very few decisions would ever be changed because of it. Suffice it to say that where DCF results are open to question on these grounds, simple cross-check calculations can be made to clear up any doubts. We hope to see an article on this problem published in the near future.

RICHARD W. HUFFMAN
Scovell, Wellington & Company
Boston, Mass.

THE AUTHOR REBUTS

Editors, THE CONTROLLER:

The thoughtful letter from Mr. Huffman defends at some length the discounted cash flow's inherent assumption that a project's profit, year by year, must be stated as a level rate of return on the unrecovered portion of the original investment. The chief argument seems to be that the annual capitalization of the profits from a given project should always be at the same rate. This "forces" a contour for the recovery of the initial capital outlay that is related to the cash flow, year by year.

The article recognizes that the depreciation contour to be used in measuring profitability may be different from that shown on the company's books or from that developed from ordinary accounting approaches. And if in the manager's judgment, the depreciation contour generated by the DCF method is appropriate, he should use that contour.

If the question to be answered is, *"What will be the rate of profit on the unrecovered portion of investment, year by year, as the project lives?"*; and if the manager can safely disregard what happens to the recovered portion of the capital, then the concept of a *level* rate of return is quite acceptable.

I believe these conditions were recognized in the original article with this paragraph:

"This brings us to the heart of the assumptions underlying the discounted-cash-flow method. It assumes either that the repayments of the principal (or the depreciation accruals if you wish to think of them in these terms) can be invested at the identical profitability rate elsewhere, or completely disregarded. If the manager, acting for the investor, can conscientiously make either of these assumptions, and if he can also accept the depreciation contour the method produces, then he can satisfactorily use the discounted-cash-flow method for measuring profitability. Otherwise, he should search for some other measure."

As far as the appropriate earnings rate to assume for the "depreciation reserve," the manager might well assign a relatively high "cut-off" rate rather than the average company rate of return, if in his judgment the general funds of the company could, on the average, be employed at the cut-off rate. On the other hand, he may deem it more realistic and more prudent to assign the rate at which he thinks the general funds, on the average, can be employed during the project's life.

One purpose of the original article was to suggest that the manager be thoroughly aware of these underlying assumptions if he chooses to use the DCF method. In some cases, further study may lead the manager to recognize weaknesses in the method that he may not see without careful analysis.

W. BERNARD THULIN
Comptroller
The Chesapeake and Potomac Telephone Company of Virginia
Richmond, Va.

PULLING POWER

Editors, THE CONTROLLER:

The help which you gave us in publicizing our need for copies of THE CONTROLLER has quickly brought results. K. W. Cooke of Southland Paper Mills, Inc., Lufkin, Texas, has generously made available a complete series of the issues from September 1945 to date. This material will be very useful in our library and we are grateful to you for your cooperation in acquiring it.

JOHN A. FROEBE
Chairman, Department of Accounting
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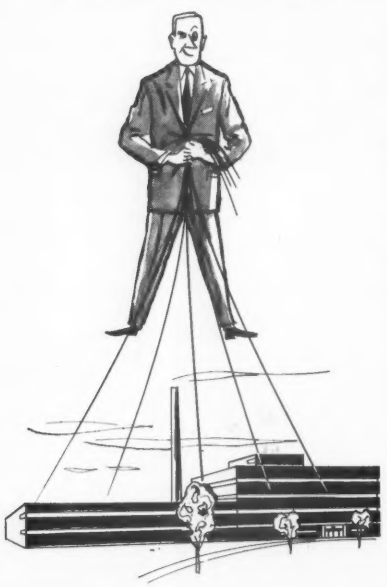
How to EXPAND Clerical Controls Without EXPENDING for Extra Facilities



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A Productivity Guide for Manufacturing Management

Applying Allen W. Rucker's productivity measurement to management control, incentive payments, product pricing and labor-management negotiation

Richard L. Hapgood

TODAY, more than ever, manufacturing industry needs simple but accurate productivity gauges to measure economic performance on a current basis. When productivity gains or losses are broken down into their various components by the current month, year to date and projected full year, the interpretation of results can be made with a minimum of guesswork. Moreover, these gauges need to be applied to manufacturing operations at various levels. They are necessary for the whole company, for individual plants of a multiplant firm, and even for product lines at a single plant. And they should reflect accurately the interdependent effects of changes and trends in volume, price, production rates, material cost, wage rates, and hours worked.

This article is an attempt to offer a practical approach to productivity which is the outgrowth of more than 30 years of research in the economics of business growth. This approach has been used by numerous concerns ranging in size from small businesses up to multiplant corporations having more than $1 billion of annual sales. This approach is an extended application of the "Rucker Share of Production Principle"[1] to the management and control of manufacturing businesses. Moreover, it is a specific application in the productivity area of the over-all management controls, described in " 'Clocks' for Management Control"[2] by Allen W. Rucker.

This principle tells us that the wage payrolls of hourly rated employes in a manufacturing concern tend to be a near-constant percentage of production value, which, with certain refinements, is the same as "value added to raw materials by manufacturing or processing," as it is termed by the U. S. Census of Manufactures. Rucker's discovery of this principle came in the early 1930's during his researches into economic relationships, using census figures initially. Afterward, he found that the principle holds just as consistently for single industries, as they are broken down in the census, and then later in many individual businesses, as well as single plants under a multiplant corporate set-up.

The consistency for all manufacturing of this relationship between hourly wage payrolls and production value has been tested for every census year since 1899, which was the first census in which hourly wages were stated separately from salaried compensation. The uniformity of this result is astonishing when one considers all the changes, ups and downs, expansions and depressions, wars and peace, which have taken place in the last 60 years.

Using the value added or production value concept as a basis for applying the Rucker principle, one is able to develop a great deal of precise data and useful information regarding the operation and control of a business, which will bridge the gap between the industrial engineer on the one hand who claims great "labor-savings" and the controller on the other who asks *"Where do these savings show up in the income sheet?"* But let's follow through the various steps of this development in logical order.

DEFINING PRODUCTIVITY

Fundamentally, according to general usage, productivity is a measure of the *rate* of business activity. It is therefore a *ratio* found by dividing output by input. Now, output or input may be expressed either in physical terms or in dollar terms, according to particular requirements.

Physical output would be expressed in terms of physical units produced, such as tons, pounds, gallons, barrels, yards, pairs of shoes, or other comparable physical units.

Dollar output would be expressed in terms of the dollar values produced. Since all figures in this analysis will be handled

RICHARD L. HAPGOOD, vice president, the Eddy-Rucker-Nickels Company, Cambridge, Massachusetts, is a graduate of Phillips Academy, Andover, Mass. He received his A.B. degree from Harvard College in 1925. He is also a CPA. His business experience since 1925 has included newspaper reporting; assisting the Dean of Harvard Dental School in administrative and business functions and public relations work; managing director of skating clubs; service in China in the U. S. Army Air Force; and the post of account executive with E-R-N Company.

[1] See "Labor's Road to Plenty," by Allen W. Rucker (Boston: L. C. Page & Company, 1937); also "Progress in Productivity and Pay" (1952) and "The Rucker Plan" (revised edition 1959) (Cambridge: The Eddy-Rucker-Nickels Company).

[2] *Harvard Business Review*, September-October 1955, p. 68.

on a production basis, rather than a sales or shipments basis, we must express output in production terms in order to obtain uniformity of analysis from period to period. Moreover, we shall state dollar output in production-value dollars, rather than sales-value dollars for cogent reasons which will become clear below.

Every manufacturing business buys raw materials, supplies, power, and so forth, from suppliers; and then converts these into its own finished products by its own factory processing. That fabrication or conversion adds value to these materials. Thus every firm makes an economic contribution of its own that did not exist before.

In essence, production value is the amount remaining after deducting from sales value (adjusted to reflect work-in-process and finished-goods inventory changes), the delivered cost of outside purchases of materials, supplies, power, and allied items used in producing the output of a given period. Accurate determination of this figure for any business, to be used as a base or in current operations, requires a detailed and comprehensive economic-engineering audit, not simply a quick review of major cost elements as shown on the yearly operating statement. Each firm has its own special circumstances and conditions, which must be given careful consideration in making this determination, even though the underlying principle is consistent in its application.

Furthermore, production value is, in fact, 100% of a firm's *internally* disposable income, since material and supply costs are essentially brokered for the firm's own customers. According to the Rucker principle, production value is shared in a near-constant ratio between the hourly rated employes on the one hand and the company on the other. The company's share is used to pay for all salaried compensation, all other operating costs and expenses, and for ownership obligations including income taxes, dividends, interest on borrowed money, and earnings retained for future expansion and development of the business.

Physical input is best expressed by man-hours worked by the hourly rated employes. Since we are here measuring "line" operations, we do not include salaried man-hours even where available, because the salaried group works essentially in a "staff" capacity, while the hourly rated employes perform "line" functions. Furthermore, man-hours worked (rather than man-hours paid for) are used because this enables us to bring into more vivid focus unwarranted extensions of pay not worked for, such as overtime premium hours, vacation and holiday hours, and so forth.

Dollar input would be expressed as the dollars of pay of the hourly rated employes. Here, again, salaried payrolls are excluded because we are measuring line operations. But contrary to the set-up for hours, these hourly payrolls will include all monies paid to, or in behalf of, hourly rated employes, including pay for time not worked and for all fringe benefits. Whether disbursed or deferred, all such hourly pay, including fringes, represents labor compensation cost to the company and should therefore be brought under the direct control of the system.

Actually, there are only two real measures of productivity: one physical and the other economic. Physical (or technoligical) productivity is found by dividing physical output by physical input. Economic productivity is found by dividing dollar output by dollar input.

The gap between these two productivity measures can be bridged by the use of three connecting ratios which are expressed in mixed terms; that is, one term of the ratio is physical and the other is dollars. This bridging the gap is accomplished in the following manner:

Physical productivity is the ratio of product units produced to the man-hours used, and measures the per-man-hour rate at which these units are flowing through a plant in a given accounting period.

The *value factor* is the ratio of production-value dollars per physical unit produced, and measures the average value in terms of production-value dollars of the firm's economic contribution to these units as they flow through the plant in the same accounting period.

These two ratios integrate into *economic productivity per man-hour,* which is found by dividing production-value dollars by man-hours. One can readily see, mathematically, that when the physical productivity ratio is multiplied by the value factor ratio, the units cancel out leaving production-value dollars per man-hour.

The *labor cost factor* is the average total compensation cost per hour of the hourly rated employes, and is found by dividing the total hourly payroll, including fringes, by man-hours worked.

Economic productivity, expressed in purely dollar terms, is the ratio of production-value dollars to hourly rated total payrolls including fringes. When economic productivity per man-hour is divided by the labor cost factor, the hours cancel out, leaving production-value dollars per dollar of hourly total compensation.

By these interrelated ratios, we have bridged the gap and have shown the steps needed to proceed from physical productivity, stated in purely physical terms, to economic productivity, stated in purely dollar terms. Actually, all these formulae or equations are derived from a corollary of the Rucker principle that unit labor costs, and hence prices, are (a) directly proportional to hourly employment costs and (b) inversely proportional to output per man-hour.[3]

A SET OF MANAGEMENT CONTROLS

It should be borne in mind that for control purposes, all these ratios can be set up not only for a company as a whole, but also for each plant of a multiplant company and even for major products or product lines when the necessary figures can be made available. Thus, the top executives who are responsible for growth and profitability can see almost instantly progress or decline in the company as a whole, from month to month as compared with the year-to-date, and with previous periods, and also for each plant or product line under the parent company. Weaknesses can be spotted quickly, inquiries can be initiated, and corrective action taken to reverse unfavorable trends which are controllable internally. Likewise, favorable trends can be observed and exploited so as to increase the profitability of the concern.

[3] See "Productivity" by A. W. Rucker, THE CONTROLLER, August 1955; and "Wages, Prices, and Productivity," 1956 and 1957 editions (Cambridge: The Eddy-Rucker-Nickels Company).

COST OF AVERAGE BUSINESS LETTER UP

The average business letter costs $1.83 today—a 13-cent increase over 1957—according to a Dartnell survey. The increase is attributed to increased labor costs (executives, secretaries, and nonproductive labor), the higher cost of materials, and increased postal rates. Suggestions for savings include shorter letters, dictating machines, centralizing stenographic and typing departments; installing bonus plans; saving in floor space by centralizing correspondence departments; more efficient labor-saving equipment; and centralized files.

Only four basic figures, from a given accounting period, are needed to compute all the above ratios: namely, physical units produced, man-hours worked by hourly rated employes, production-value dollars generated, and hourly wage payrolls including all nonwork pay and all fringes. These are then combined to form the primary productivity and other bridging ratios, as above described.

It is apparent that the complete development of all these ratios is dependent upon the firm's having a physical measure of output. It is recognized that many firms engaged in a multiproduct type of business will not readily have such a measure. In cases where it is absolutely impossible to develop a physical measure of output, or some reasonable estimate of it, we can still measure economic productivity per man-hour, the labor cost factor, and economic productivity. And from these much useful information can be obtained, albeit not so complete as might be desired.

However, it often develops that in a multiproduct type of operation a reasonable basis for estimating a physical measure of output can be found.

Many companies have had industrial engineering or methods studies, which have enabled them to determine "standard hours" for all or most of the direct labor jobs. In such cases, the standard hours figure for any accounting period can become the physical measure of output, and when divided by man-hours worked provides an entirely acceptable measure of physical productivity. The proportion of direct labor jobs measured by standard hours, of course, conditions the validity of the measure.

Certain companies have one principal product plus various side lines. Taking the number of units of the principal product sold and dividing it into the sales dollars obtained from such sales will give an average price per product unit for that accounting period. Then, this average price divided into the sales of all other products, as well as into the inventory change, will give equivalent units produced in terms of the principal product.

One company, in our experience, making sewing machines and parts, was able to determine an average machine price and then to convert all other sales into equivalent machines.

Another company, in our experience, making doors and door frames, found by comparing average selling prices that 19 door frames were equivalent to one door; hence production in door frames divided by 19 gave physical output in terms of equivalent doors.

These are just a few examples of the devices by which a physical measure of output can be approximated, and if one takes into account the degree of approximation, one can evaluate the degree of reliability in applying and interpreting these productivity ratios for control purposes. Even a rough approximation can provide a useful guide to what is taking place, and is better than none at all, if reasonably interpreted.

THE THIRD IN A TRILOGY

Shown welcoming the arrival of Controllers Institute Research Foundation's latest and heftiest research report—*Corporate Records Retention, Volume 3: A Guide to Requirements of State Governments of the U. S.*—are *(left to right)* Robert A. Wheelan, Foundation research associate and compiler of the volume; Robert L. Dickson, president of the Foundation; and W. Joseph Littlefield, research director. Turn to pages 244-245 for a detailed listing of its contents.

Now, the operation of any control depends initially upon developing a standard or bench mark as a base, and then upon comparing current performance against that standard, to see whether improvement or decline has occurred. Therefore, in setting up the basis for these controls, one must initially select a recent operating period, make the necessary determinations of the four figures required, and then combine them into the productivity and other ratios as above described. Generally, for this purpose, a minimum of five operating years should be analyzed, by means of a detailed economic-engineering audit study, in order to determine the stability of the business under varying internal and external pressures over a continuous period of time, and to observe cyclical, as distinct from seasonal, trends. It may subsequently develop that less than five years becomes the base period for the standard, or bench mark, depending upon the particular use and application of the principle, according to local conditions and individual needs. Usually, it is unwise to set the standard on the basis of one year, since that year may be good, or bad, and thus not representative of average performance.

After the base period has been established, and the standard productivity ratios determined for that period, we now have a sound basis for comparing performance in any current operating period, whether short-term or long-term. In order to make the comparison more meaningful, it has been found desirable to convert the ratios into index numbers, since these readily show the percentages of gains or losses from standard for any one of the measures. Taking the base period ratios as 100, we compute indexes for each ratio in the current period, and the same mathematical relationships of multiplication and division will hold for these index numbers as for the ratios themselves.

Thus, when the index of physical productivity is multiplied by the index of the value factor (divided by 100), we will obtain the index of economic productivity per man-hour. Likewise, when the index of economic productivity per man-hour is divided by the index of the labor cost factor (times 100), it will give us the index of economic productivity (production values per dollar of hourly total compensation).

PLANT-WIDE INCENTIVE OPPORTUNITIES

When the indexes of the current period's ratios have been determined, showing improvements or declines, the following points should be considered in interpreting the results:

Improvement in physical productivity is fundamentally a matter of better labor utilization, or the reciprocal of labor-time

savings per unit. Although management is responsible for the over-all policy and long-range planning that yield these improvements, the hourly workers themselves can be an active factors in such results—direct production workers for increasing the flow of work through the plant, eliminating bottlenecks, and minimizing lost time; material handlers, maintenance men, and other indirect workers for helping productive workers in every way and keeping the equipment and tools in good running order.

Management also contributes to improvement in physical productivity—immediately and on the spot by developing alert and capable foremen, and also by improving product design and developing better methods, as well as by judicious investment in better tools and equipment.

Improvement in the value factor is largely the responsibility of management through pricing and product-line policies that will maximize sales income and through careful purchases of materials and supplies at favorable prices.

Employes can also contribute toward improving the value factor through better quality work (thereby reducing customer returns and scrapped work) and through reduction of wastage in the use of materials and supplies.

Improvement in economic productivity per man-hour reflects the combined changes in physical productivity and the value factor, and this represents the joint efforts of employes and management working together as a team to promote the prosperity of the company.

Both hourly employes and management can be stimulated greatly toward making these improvements when the Rucker principle is applied as a plant-wide group incentive pay plan for the hourly rated employes.[4]

Since the value factor is stated in terms of production-value dollars per physical unit of output, it is obvious that this ratio and its index will reflect the combined effect of changes in a number of components. Thus, anything that increases or decreases production value has a direct bearing on improvements or declines in this index.

There are the dollar components, which include optimum selling prices that will attract more orders from customers, careful purchasing of materials and supplies so that unit costs of these items are minimized.

There are the quality components, which include not only keeping customer returns and allowances at a minimum, but also internally the reduction of wastage, scrapped work, and rework.

There are the utilization components in the physical usage of materials and supplies, thus keeping costs down.

And, finally, there is the volume component, whereby production values are increased by turning out more finished products without increase in man-hours or hourly payrolls.

Because of this complexity of elements, it is sometimes desirable to break down the value factor into its major contributory components, in order to pinpoint more precisely the nature and extent of favorable and unfavorable changes in relation to average base period activity. This is done by developing subsidiary ratios in terms of per-physical-unit-of-output. The per-physical-unit ratios needed would be for gross sales value per unit, customer returns per unit, net sales value per unit, raw material cost per unit, and supply cost per unit. If desired, the supply cost per unit can be further broken down into production supplies, general supplies (including power), and maintenance supplies per unit produced.

All these ratios can be converted to index numbers, by dividing the current period's ratios by the base period ratios, taken as 100. Three of these ratios, namely, customer returns, material cost, and supply cost, are deductions from income; thus, when the current period shows improvement, the index as normally computed would come out to less than 100, or if it shows a decline, the index will be greater than 100. In order to have all indexes greater than 100 to show improvement and less than 100 to show declines, we have to reverse these indexes for this purpose. Thus, if the current material cost per unit produced is less than the base, say 98; then the index should be reversed (100 less 98 plus 100) to show 102.

Two exhibits have been prepared to illustrate the development and use of these productivity ratios and indexes. *Exhibit I* shows the over-all application of the principle for control purposes, and *Exhibit II* shows the detailed break-down of the value factor, as described above.

In *Exhibit I,* we can see from the indexes of the current period that physical productivity is 3.85 per cent above standard, the value factor is 7.92 per cent above standard, and economic productivity per man-hour, which is the integration of these two, is 12.07 per cent above standard. The labor cost factor, or average hourly compensation rate, has increased slightly, possibly due to scheduling more overtime than the base period average. And the gain in economic productivity (production value per dollar of payroll) is 11 per cent, all of which is retained by the company except when applying the Rucker principle as a pay incentive plan, as will be explained below.

In *Exhibit II,* we can see from the indexes which items have contributed to the 7.92 per cent gain in the value factor. Some of it came from slightly higher selling price as reflected in gross sales value of output per unit, at 3.65 per cent higher than base. Some came from proportionately reduced returns and allowances. And the rest of it came from proportionately reduced material and supply costs.

It is, of course, true that changes in the

"One of your employes is stealing! Every month there is less in my account than my stubs show!"

[4] Although this current discussion is restricted to consideration of performance by hourly rated employes, application of the Rucker principle is often extended to include incentives for all salaried personnel such as mid-management, top management, or all groups together.

EXHIBIT I—PRODUCTIVITY RATIOS AND INDEXES

	Three-Year Base Period	*Current Period*
Control Computation:		
Gross Sales Value of Output	$4,950,000	$ 184,700
Less: Returns & Allowances	150,000	4,950
% to Gross Sales Value	3.03%	2.68%
Net Sales Value of Output	$4,800,000	$ 179,750
Material Cost	$1,440,000	$ 51,000
% to Net Sales Value	30.00%	28.37%
Supply Cost	360,000	12,200
% to Net Sales Value	7.50%	6.79%
Material & Supply Cost	$1,800,000	$ 63,200
% to Net Sales Value	37.50%	35.16%
Production Value	$3,000,000	$ 116,550
Standard Allowable Payroll at 40% of Production Value	$1,200,000	$ 46,620
Hourly Total Compensation	1,200,000	42,000
Excess of Allowable over Actual	$ NONE	$ 4,620
% to Hourly Compensation	0%	11%
Basic Data:		
Units Produced	1,500,000 un	54,000 un
Hourly Man-Hours Worked	600,000 hr	20,800 hr
Production Value Dollars	$3,000,000	$ 116,550
Hourly Compensation Dollars	$1,200,000	$ 42,000
Productivity Ratios:		
Physical Productivity	2.500 00	2.596 15
Value Factor	2.000 00	2.158 33
Economic Productivity Per Man-Hour	5.000 00	5.603 37
Labor Cost Factor	2.000 00	2.019 23
Economic Productivity	2.500 00	2.775 00
Productivity Indexes:		
Physical Productivity	100.00	103.85
Value Factor	100.00	107.92
Economic Productivity Per Man-Hour	100.00	112.07
Labor Cost Factor	100.00	100.96
Economic Productivity	100.00	111.00

EXHIBIT II—DETAILED ANALYSIS OF VALUE FACTOR

	Base Period	*Current Period*
Control Computation:		
Gross Sales Value of Output	$4,950,000	$ 184,700
Less: Returns & Allowances	150,000	4,950
Net Sales Value of Output	$4,800,000	$ 179,750
Material Cost	$1,440,000	$ 51,000
Supply Cost	360,000	12,200
Material & Supply Cost	$1,800,000	$ 63,200
Production Value	$3,000,000	$ 116,550
Units Produced	1,500,000 un	54,000 un
Ratios (per Unit):		
Gross Sales Value of Output	3.300 00	3.420 37
Returns & Allowances	.100 00	.091 67
Net Sales Value of Output	3.200 00	3.328 70
Material Cost	.960 00	.944 44
Supply Cost	.240 00	.225 93
Material & Supply Cost	1.200 00	1.170 37
Production Value (Value Factor)	2.000 00	2.158 33
Indexes:		
Gross Sales Value of Output	100.00	103.65
Returns & Allowances	100.00	108.33
Net Sales Value of Output	100.00	104.02
Material Cost	100.00	101.62
Supply Cost	100.00	105.86
Material & Supply Cost	100.00	102.47
Production Value (Value Factor)	100.00	107.92

NOTE: The indexes for Returns & Allowances, Material Cost, Supply Cost, and Material & Supply Cost, have been reversed so that when performance is *better* than standard, the index is *higher* than 100.

value factor can be caused by changes in the product mix as well as changes in selling price and costs. When, in a particular period, there is a concentration on the larger-sized physical units, average prices and costs per unit will be proportionately higher, and vice versa. But the business executive will be aware of that, at the time it is happening, and can modify his interpretation of results to compensate for product mix changes.

Sometimes, changes in the product mix will influence the ratio of physical productivity, as well as the value factor. This occurs when larger units flow through the plant at a slower rate, but because of that fact, command higher prices. The reverse of this situation was seen in our experience in a company manufacturing set screws. The usual lines of screws were fabricated from steel, and flowed through the automatic screw machines at a normal rate of about 8,000 per day. On one occasion, the firm obtained a large order for the same screws, but to be made of aluminum. A much lower price per thousand was quoted, which depressed the value factor in terms of production value per thousand screws; but because of the softer metal, the machines could fabricate them at a rate of about 11,000 per day, which raised the index of physical productivity substantially.

Whether the increased physical productivity with aluminum was enough to offset the lowered price can be found by their integration in the index of economic productivity per man-hour. So long as this latter index is 100 or more, the company can be assured that it has not given away too much in the lowered price and that the increased physical productivity was enough to recoup adequate values. Tests of this sort are useful in determining proper pricing so that the company's profit position is adequately protected.

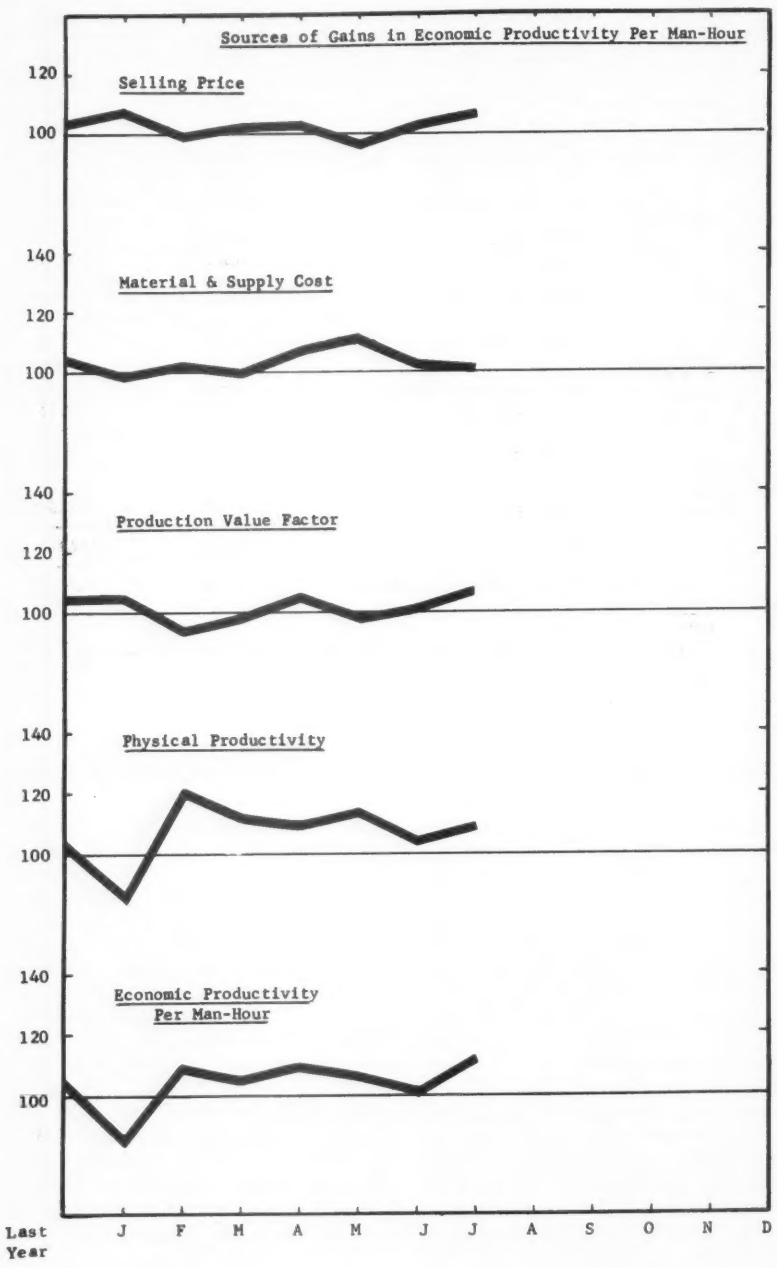
Two additional exhibits have been prepared to illustrate the use and application of these indexes. *Exhibit III* shows the sources of gains in economic productivity per man-hour, as obtained from month to month from improvements or declines in selling prices, material and supply costs, production value per unit, and physical productivity. One can quickly see which lines, moving up or down, have the most marked influence on gains or losses from the base period standard. *Exhibit IV* shows the disposition of gains

(Continued on page 212)

in economic productivity per man-hour, showing how much is regularly absorbed in regular hourly pay including all fringes and how much could be applied to incentive pay payments or to wage-rate increases, without disturbing the standard economic relationships established in the base period. These charts were taken from the actual results of a company, which happened to be using the incentive plan for hourly rated employes.

In addition to the over-all management controls of a business, which are readily apparent from a study of these exhibits, there are other important and valuable applications of the share of production principle in relation to the management of a business.

EXHIBIT III—X MANUFACTURING COMPANY—PRODUCTIVITY INDEXES (Monthly)



A USEFUL TOOL IN THE FIELD OF PRICING

The first of such other applications is in the field of pricing the product, employing a corollary of the Rucker principle that has long been used by firms to determine a selling price that will assure protection of the company's standard ratio of economic productivity. Given the direct material and direct labor costs of a product, or product line, the technique of such pricing is as follows. To the direct labor cost is added a factor to cover all the remaining (indirect) hourly labor and all fringe benefits costs. This total hourly labor cost of the product is then multiplied by the ratio of economic productivity (2.5 as shown in the example in *Exhibit I*) to get the production value that should be obtained from the sale of the product. Then to the product's production value is added the direct material cost plus a factor for supplies, and the resulting figure is the minimum selling price that should be obtained for it to maintain the firm's economic position.

Another application is the use of the principle as the basis of a plant-wide incentive pay plan for all hourly rated employes. Thus, when the current period's economic productivity is higher than base period standard, the excess becomes available as added earnings for the participating employes. In the example in *Exhibit I*, the current period's economic productivity index is 111.00, or 11 per cent better than standard, and the employes may be paid up to 11 per cent of the regular total pay as incentive, or added, earnings, all without infringing on the company's normal share of production values. In the control computation in *Exhibit I*, it will be seen that the standard allowable payroll in the current period, at 40 per cent of production value (the reciprocal of 2.5) is $46,620, whereas total hourly compensation is only $42,000. The difference between them of $4,620, which is 11 per cent of $42,000, is the dollar amount available for distribution to the hourly employes as added earnings.

USING THE PRINCIPLE IN UNION NEGOTIATIONS

Still another application of the principle is in connection with union negotiations over increased wage rates and benefits, in cases where the principle is not being used as the basis of an incentive pay plan. Thus, as shown in *Exhibit I*, the actual current average wage rate of the hourly employes is $2.019 per hour. Let us suppose that the union's demands for increased regular rates and increased fringe benefits amount to 25 cents per hour. *Can this amount be justified by the increases in physical productivity and the value factor?*

A 25-cent increase would bring the current rate of pay up to an average of

$2.269 per hour. This figure divided by the base rate of $2.000 per hour gives an index of 113.46, as the new labor cost factor. This index of 113.46 is greater than the 112.07 index of economic productivity per man-hour, which measures the over-all gains from base of physical productivity and value factor combined. Thus, the improvements obtained do not justify a wage increase of 25 cents per hour.

If, however, you multiply the current rate of $2.019 by 111 per cent, you get $2.241 per hour as the allowable new rate, justified by the improvements in physical productivity and value. And this is an increase of only 22.2 cents per hour ($2.241 less $2.019). So from a bargaining point of view, the management negotiators know precisely to the tenth of a cent how much they can yield to union demands for increased rates and fringe benefits.

In one company we know of, a computation of this type convinced the union negotiators of the justice of management's position, and they were willing to settle for a lesser increase that would not unbalance the company's standard of economic productivity.

In conclusion, we feel that there is an outstanding need for a team-work measure of plant-wide economic productivity and current performance against a carefully engineered standard. Thus, the development and use of the Rucker share of production principle can be most valuable in many ways:

First, it can clear away much of the confusion and misunderstanding that now exists about productivity, what it is and how to measure it.

Second, it provides a comprehensive set of management controls that are presently unobtainable from the conventional form of monthly financial statement.

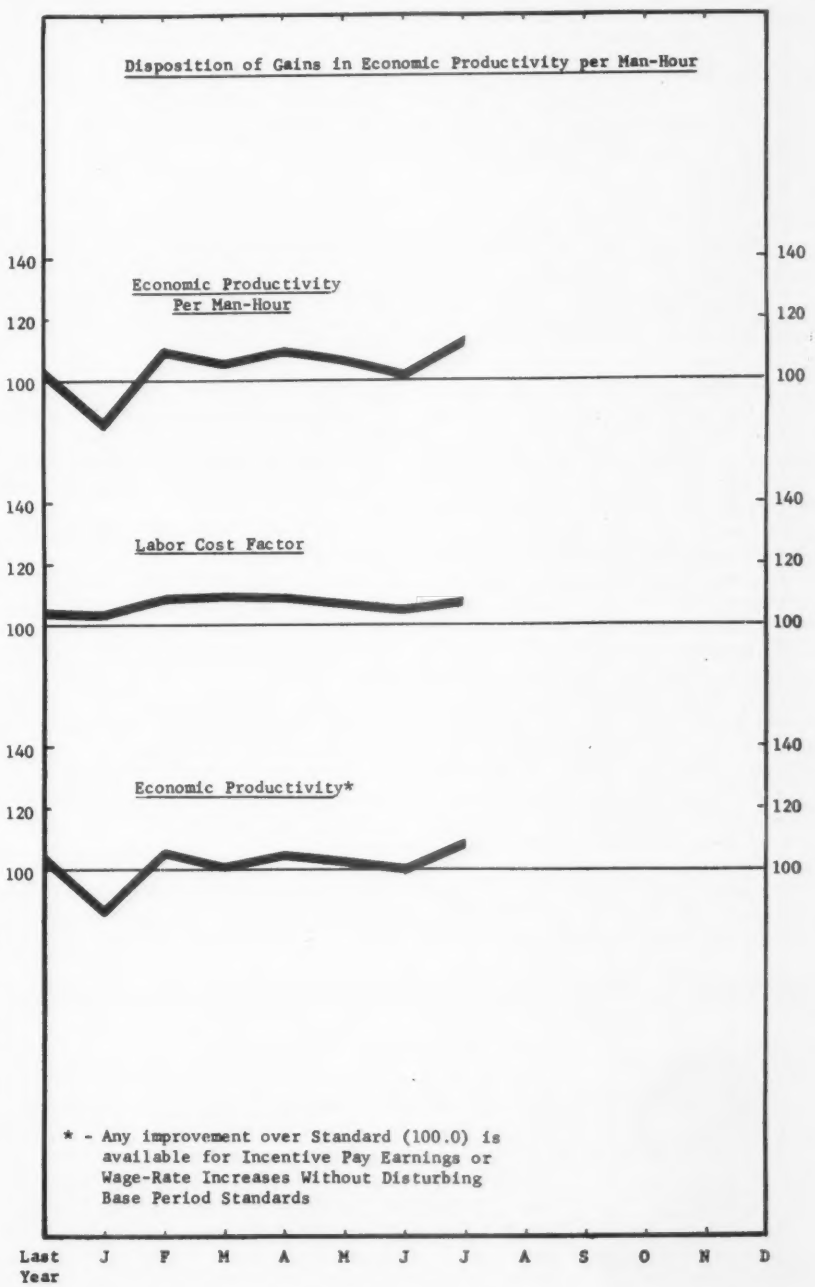
Third, it has been successfully used as a plant-wide incentive pay plan for hourly rated employes. It has increased coverage to 100 per cent of the time worked by all hourly rated employes, instead of the 70 per cent to 90 per cent of the time worked by 40 per cent to 60 per cent of the employes, as normally prevails with individually measured incentives. And it has increased the area of incentive opportunity from merely more units per man-hour to include all the value factors involved including higher or lower selling prices. Thus, the management is not forced to pay added money for greater physical output, irrespective of the prices realized in market competition.

Fourth, it is a useful tool in pricing the product to assure that receipts from sales are adequate to maintain or improve the standard of economic productivity; and when competition cuts the price below this point, the company may find it wise to allow some portion of that unprofitable business to go to those competitors.

Fifth, it is most useful in union negotiations, by enabling management to measure in exact terms the actual monetary and percentage gains in economic productivity and then to determine precisely how much of an increase they can afford to pay without altering the former stable balance of the company's performance.

All these applications have been tested in the field among a number of companies of varying sizes, and found to be valuable and accurate for the purposes outlined.

EXHIBIT IV—X MANUFACTURING COMPANY—PRODUCTIVITY INDEXES (Monthly)


Disposition of Gains in Economic Productivity per Man-Hour
Economic Productivity Per Man-Hour
Labor Cost Factor
Economic Productivity*
140
120
100
* - Any improvement over Standard (100.0) is available for Incentive Pay Earnings or Wage-Rate Increases Without Disturbing Base Period Standards
Last Year
J F M A M J J A S O N D

Sales-Oriented Overhead Costing

David H. Li

A new concept grounded on "cost transferability"

IN VIEW of the fact that manufacturing today is geared increasingly to marketing considerations rather than to production, it seems rather surprising that we find absorption costing still widely practiced. Absorption costing owed its origin to the one-time universal emphasis on productive capacity and logically accompanied it. Present conditions call for a new concept of overhead costing.

The proposed costing concept, for want of a better term, will be designated as sales-oriented overhead costing. Under this concept, plant facilities are acquired not because of their productive capacity *per se,* but because of their capability to service a certain level of sales needs. Fixed overhead costs, therefore, are to be allocated on the basis of expected average sales, rather than on the basis of productive capacity or utilization.

In a year in which the actual sales volume *coincides* with the expected average sales volume, fixed overhead costs will be fully absorbed and reflected in the cost of goods sold account irrespective of production. Should the number of units produced exceed that sold, the excess units are inventoried at their direct costs.[1] Conversely, should the number of units sold exceed that produced, the necessary units drawn from inventory are included in the cost of goods sold at their direct costs.

In a year in which actual sales *fall below* expected average sales, a part of fixed overhead costs will not be absorbed and is to be treated as an expense (technically, a loss) irrespective of production. Units produced in excess of sales or units drawn from inventories are transferred at their direct costs.

In a year in which actual sales *exceed* the expected average sales, fixed overhead costs will again be fully absorbed. Units sold in excess of expected sales, irrespective of whether they are supplied by current production or drawn from inventories, are to be included in the cost of goods sold account at their direct costs.

There are altogether 13 possible combinations of expected sales-actual sales-production relationship. The allocation of overhead costs under each situation, together with its effect upon net income, is illustrated in *Table 1* on pages 216 and 217.

From *Table 1,* several observations may be made:

Firstly, unabsorbed fixed overhead costs exist so long as actual sales are below expected sales; such unabsorbed costs gradually diminish as actual sales approach expected sales;

Secondly, fixed overhead costs are fully absorbed when actual sales are equal to or in excess of expected sales;

Thirdly, net income moves in the same direction as actual sales; the higher the actual sales, the higher the net income becomes;

Fourthly, net income is not affected by inventory policy; at a given actual sales volume, net income remains the same irrespective of whether inventory is being accumulated, liquidated, or kept unchanged; and

Finally, the percentage markup (gross margin to sales) remains unchanged when actual sales are equal to or less than expected sales; it begins to improve and gradually widens with additional sales above the expected sales volume.

The significance of these observations will be examined in connection with justifying the proposal in terms of managerial considerations. Attention will first be directed, however, to justifying the proposed concept in terms of theoretical considerations.

THEORETICAL CONSIDERATIONS

Cost accounting as a methodology is based upon the "cost-attach" concept. Paton and Littleton, two of the leading accounting theorists, explain the concept in the following manner:

> The economic activity of a business enterprise consists in uniting materials, labor, and various services to form new combinations having *new utilities.* . . . When production activity effects a change in the form of raw materials by the consumption of human labor and machine-power, accounting keeps step by classifying and summarizing appropriate portions of materials cost, labor cost, and machine cost so that together they become product-costs. In other words, it is a basic concept of accounting that costs can be marshaled into new groups that possess *real significance.* It is as if costs had a power of cohesion when properly brought into contact.[2]

They further state that the reason for such regrouping of costs is that they express parts of the total effort made to bring about a subsequent advantageous sale.[3]

(Continued on page 216)

[1] Direct cost is the sum of direct material, direct labor, and that portion of manufacturing costs that vary directly and proportionately with volume; see *Direct Costing,* Research Series No. 23 (New York: National Association of Cost Accountants, 1953), pp. 10-11.

[2] W. A. Paton and A. C. Littleton, *An Introduction to Corporate Accounting Standards* (Chicago: American Accounting Association, 1940), p. 13. (Emphasis supplied.)

[3] *Ibid.,* p. 14.

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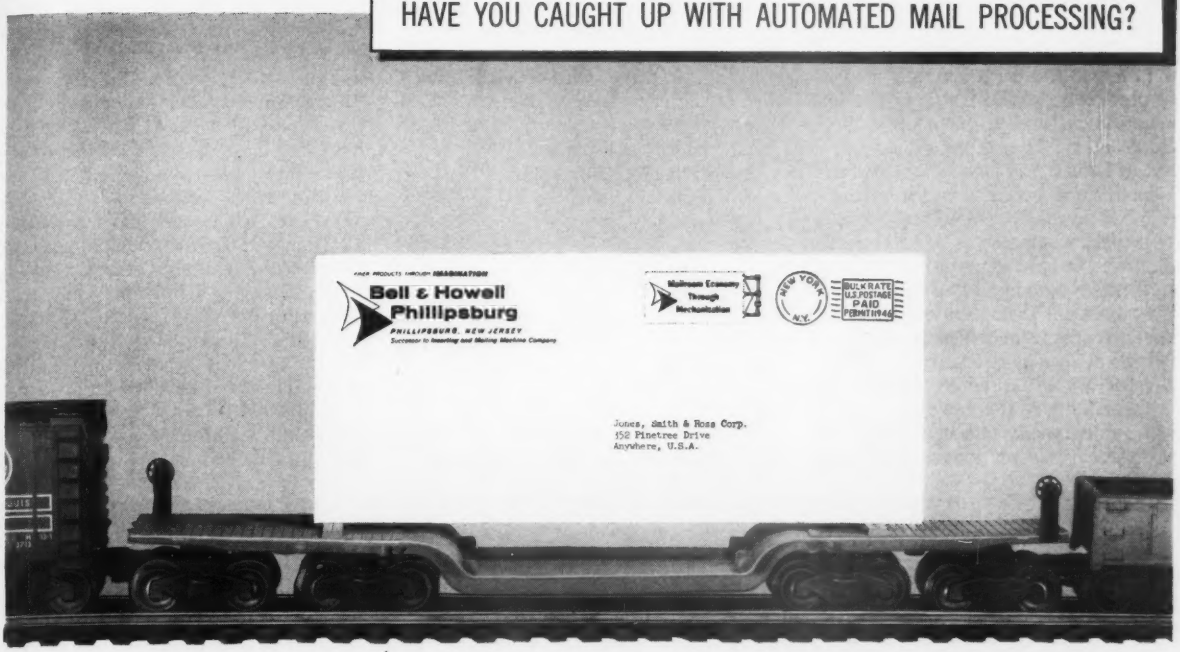

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The cost-attach concept, it seems to the writer, is based on two assumptions. It assumes (1) that the most important aspect of economic activity is production, and (2) that sales in some years may exceed production at full capacity. The first assumption is basic to a production-oriented economy. The second assumption—that the efforts made and costs incurred in producing goods can be readily and advantageously passed to the customer in subsequent years—is a corollary to the first and a symptom of a production-oriented economy. This is the basis for conventional absorption costing.

In an economy in which marketing is the focus of managerial attention and excess capacity the desired managerial policy,[4] the validity of these two assumptions may be questioned. The cost-attach concept, it seems, is no longer satisfactory as the criterion for cost determination. In its stead, the writer wishes to propose the "cost transferability" concept.

Under the cost transferability concept, costs are incurred with a view toward their recoupment when sales are made. The utility or significance of costs depends not so much upon their incurrence as upon their transferability. Costs are useful when they may be transferred to customers, through sales; they are not when they cannot be so transferred. The cost-attach concept is valid in a production-oriented economy not because costs do attach (a physical concept) but because they are transferable (an economic concept); in other words, in a production-oriented economy, cost transferability may be equated to and substituted by cost-attach. In a sales-oriented economy, however, the cost transferability concept must prevail.

At the time of incurring costs, the sales volume to which such costs are directed is estimated. Such a sales estimate tends to reflect the feasibility of incurring costs, a step consistent with management's planning function. The expected sales volume, the criterion for justifying cost incurrence, then becomes the basis for determining cost transferability.

In planning an advertising campaign, for example, the expected sales level at which such a campaign is aimed is estab-

[4] Cf. "Too Much Manufacturing Capacity?" *Business in Brief* (New York: The Chase Manhattan Bank), November-December 1958: "A review of past trends also suggests that a certain amount of excess capacity has been considered desirable by manufacturers. They want enough elbow-room to handle orders efficiently and promptly in periods of good business."

TABLE I

ALLOCATION OF OVERHEAD COSTS AND DETERMINATION OF NET IN[illegible] VA[illegible]

	Actual Sales = Expected (12,000 units) (12,000	
Assumption : Direct Material Cost per unit $1 Direct Labor Cost per unit 2 Direct(Variable)Overhead Cost per unit 1 $4 Fixed Overhead Cost per unit (base: 12000) 2 $6	With Production at 14,000 Units	With Production at 12,000 Units	With Pro- du[illegible] at [illegible] Units
Sales @ $10	$120,000	$120,000	$12[illegible],000
Cost of Goods Sold			
Units up to 12,000 supplied by current production @ $6	72,000	72,000	6[illegible],000
Units in excess of 12,000 supplied by current production @ $4	-	-	
Units drawn from inventory @ $4	-	-	
Overhead absorbed for units drawn from inventory @ $2 up to 12,000 units less number of units produced	-	-	
Gross Margin	$ 48,000	$ 48,000	$ 4[illegible],000
Selling and Administrative Expenses	10,000	10,000	1[illegible],000
Unabsorbed Fixed Overhead Costs, 12,000 units less units sold @ $2	-	-	[illegible],000
Net Income	$ 38,000	$ 38,000	$ 3[illegible],000
Inventory Accumulation or (Liquidation) in units	2,000	-	([illegible],000
Inventory Balance, Cumulative in units	2,000	2,000	[illegible],000

lished. Should actual sales fall below the expected sales, it suggests that the campaign is less than completely successful and that part of the advertising cost cannot be transferred to customers. The part that cannot be transferred is a cost that does not contribute, a cost that is not useful—or, in short, a loss. Under conventional income reporting, advertising cost is treated as an expense and deducted *in toto* from revenue of the period; as such, the distinction between a useful advertising cost and an advertising loss is academic, though such a distinction is highly desirable and capable of implementation under the cost transferability concept.

In planning plant acquisitions, similarly, the expected sales level to which such acquisitions are destined to service is established. Since plant acquisitions will benefit several accounting periods, the expected *average* sales level during such periods is established. Should actual sales in any period fall below the expected average sales, it suggests that part of fixed overhead costs of that period cannot be transferred to customers; such unabsorbed costs should then be considered a loss and deducted from revenue of the period.

Would the treatment be different if management elects to produce more than the current sales needs?

Inventory accumulation (and subsequent inventory liquidation) in an era of excess productive capacity is a reflection of management's financial policy; it is *not* an economic necessity. A financial transaction has no bearing upon net income; as such, under sales-oriented overhead costing, unabsorbed fixed overhead costs of any period are treated as a loss of that period irrespective of management's inventory policy. That part of fixed overhead costs that has been transferred to customers is a useful cost and is properly treated as an element making up the total costs of goods sold.

MANAGERIAL CONSIDERATIONS

From the managerial standpoint, the sales-oriented overhead costing concept offers several advantages over both absorption and direct costing concepts.

In the first place, at the time of planning acquisitions, the sales-oriented concept is consistent with the managerial approach in that plant acquisitions are viewed in terms of their capability to service a certain level of sales needs and not in terms of their productive capacity

(Continued on page 242)

TABLE I CONTINUED

VARIOUS EXPECTED SALES-ACTUAL SALES-PRODUCTION RELATIONSHIPS

Actual Sales < Expected Sales (10,000 units) (12,000 units)					Actual Sales > Expected Sales (14,000 units) (12,000 units)				
With Production at 12,000 Units	With Production at 11,000 Units	With Production at 10,000 Units	With Production at 9,000 Units		With Production at 15,000 Units	With Production at 14,000 Units	With Production at 13,000 Units	With Production at 12,000 Units	With Production at 11,000 Units
$100,000	$100,000	$100,000	$100,000		$140,000	$140,000	$140,000	$140,000	$140,000
60,000	60,000	60,000	54,000		72,000	72,000	72,000	72,000	66,000
-	-	-	-		8,000	8,000	4,000	-	-
-	-	-	4,000		-	-	4,000	8,000	12,000
-	-	-	2,000		-	-	-	-	2,000
$ 40,000	$ 40,000	$ 40,000	$ 40,000		$ 60,000	$ 60,000	$ 60,000	$ 60,000	$ 60,000
10,000	10,000	10,000	10,000		10,000	10,000	10,000	10,000	10,000
4,000	4,000	4,000	4,000		-	-	-	-	-
$ 26,000	$ 26,000	$ 26,000	$ 26,000		$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000
2,000	1,000	-	(1,000)		1,000	-	(1,000)	(2,000)	(3,000)
6,000	7,000	7,000	6,000		7,000	7,000	6,000	4,000	1,000

Essentials of Corporate Planning

Frank S. Capon

"Consult the maps . . . to take the fullest advantage of known facts and assumed events"

Should your company boost its outlay for product development in the next few years?

Is the Southeast Asian market worth developing for the equipment you make?

Would it make sense to set up a new, highly automated processing unit in a region now served by means of long-distance rail haulage?

Questions such as these, varied and difficult as they may be and important as they surely are, can all be answered after recourse to certain principles of analysis and planning. Without such recourse, in fact, they cannot be answered adequately.

Mr. Capon sets forth these principles as he sees them, leading off with a word about the manner in which authority for planning is assigned.

THE ORGANIZATIONAL STRUCTURE of different companies varies widely, partly because of size but frequently because of personal preference for certain titles or groupings. Fundamentally, however, the various responsibility groups in management are strikingly similar in all companies. For example, the chief executive officer has general responsibility for all aspects of management regardless of whether he is a president, a chairman or managing director. Similarly, all companies have a financial management responsibility regardless of whether it comes under the vice president (finance), the treasurer or the controller. For manufacturing companies there will be a production responsibility even though it may be decentralized on a product basis, and there will also be a sales responsibility which may be similarly decentralized. Most companies will have a development responsibility which may or may not include research. There is a similarity of functional responsibilities in every organization regardless of the titles used.

In recent years there has been a great deal of discussion on centralization and decentralization of management and also of the pros and cons of committee management. It is not necessary for purposes of this discussion of planning and of control to consider the advantages or disadvantages of decentralization or of the committee structure. The principles of planning and control apply equally regardless of whether or not a company is decentralized and whether management responsibilities are vested in individuals or in committees.

FRANK S. CAPON, a past director of Controllers Institute, gave this talk at a Cost and Management Conference at Queen's University, Kingston, Ontario. Born and educated in England, he came to Canada in 1930 and joined Riddell, Stead, Graham and Hutchison, Montreal, Quebec. In 1938 he joined Canadian Industries Ltd. (appointed assistant treasurer 1946; treasurer 1949) and in 1954 became secretary and treasurer of Du Pont of Canada Ltd.; is now treasurer and a director of the company. He holds a C.A. degree from Quebec Institute of Chartered Accountants.

REASONS FOR PLANNING

The only link between an aim and its achievement is the plan of the steps or actions needed to get there and the order in which they must be taken. Those who aim to succeed by planning their course have a tremendous advantage over the great number who have no organized plan; the planners are ready for each development, and can take each necessary decision without hesitation because the various alternatives have been evaluated, whereas those who fail to plan must scurry around making hasty and ill-considered decisions every time a new development occurs. The planner has command of his course of action, has foreseen the probable difficulties, and has charted his course around them. He keeps his head while others lose theirs, for hurry and surprise are the two most dangerous situations in business.

The person who plans will first make sure where he is at present, and then determine his objectives. The planning of achievement of objective then takes a two-part form: strategy and tactics. The executive must determine the strategy by painting with a broad brush, but he can delegate decisions on tactics, for junior levels of management must be able to make day-to-day revisions in minor aspects of the plan, always keeping within the broad strategy.

The mere committing of objectives and plans to paper will of itself give guidance and generate ideas. Even when only difficulties seem ahead, a formal analysis and evaluation of possible courses of action will give a sense of balance and self-confidence. One great fault of our age is the tendency to rush into new ventures

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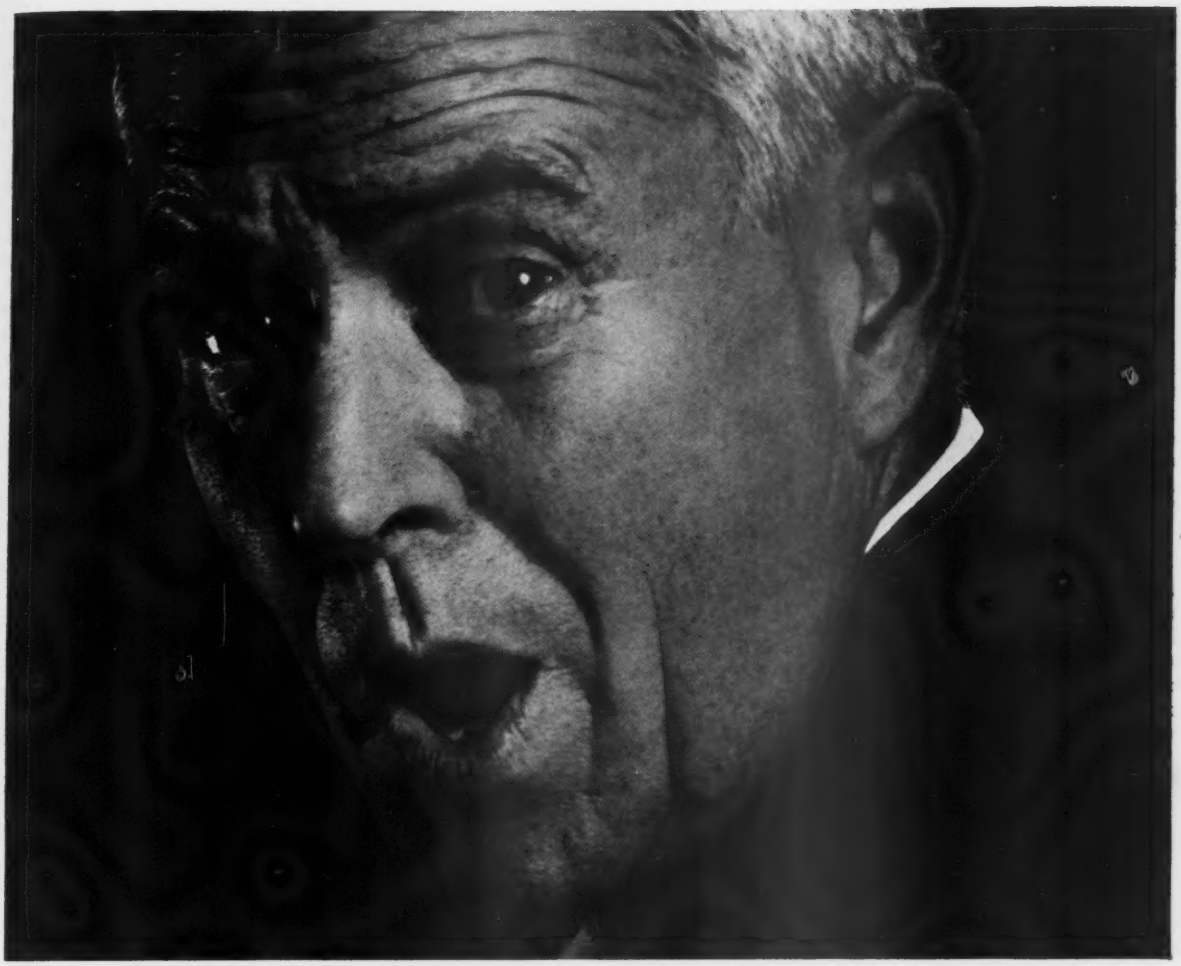

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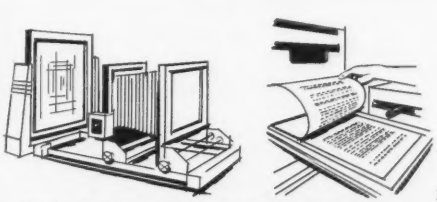

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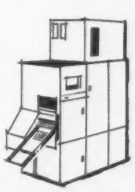

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without enough study because of an overpowering fear that someone else may get there first. There is a mad endeavor to leap from the ground to the summit rather than to climb scientifically, disregarding the infinitely greater risks involved in the leaping process. Many things are already known about the future but the timing of the great events foreseen remains cloaked in mystery. Thinking men are trying to establish rough dates for the major steps, and are working towards these dates; they are planning the actions they must take and the timing of these actions in order to be in the right position in 10 or 20 years. Orderly plans mean fewer unsolved problems, fewer false starts, an absence of random-work. In other words, planning results in a vital decrease in effort and increase in future efficiency, even if the planner himself may not be around to reap the fruits.

SCOPE OF PLANNING

A plan is no better than the men who make it, and objectives will be accomplished only if the right men are there to take the necessary decisions and actions. The organization function, that is the hiring, training and developing of men, is certainly the most important single task of management, for all of management's achievements must be accomplished through people and a good organization can only be built up by meticulous planning and careful but firm pruning.

The scope of corporate planning, the degree of formality needed, the frequency of plan reviews, the timing of formal plan submissions, are all matters which must be custom-made for each company. Planning in some form takes place in every company, large or small, but in many it may be unconscious or relatively undeveloped.

Business is a venture, in some ways no different from a family motor trip. If you were taking the family away in the car for a few weeks, you would first obtain guide books, lists of hotels and all other information on the facilities available. In other words, you would obtain all present facts. Then you would consult the maps to determine the best way of reaching your destination. To ensure a successful trip, you would ascertain first what to expect and how to get there and then you would make all necessary reservations in advance; thus you would have guarded against disappointment and unnecessary trials enroute. We all know the kind of problems experienced by those carefree individuals who just barge off in the car at the height of the vacation season without any particular arrangements or plans.

Planning can be summed up as the collection of all pertinent facts which may affect directly or indirectly future results or that part of the future now under study, the thoughtful weighing of those facts to test their accuracy, the evaluation of various pieces of information and the determination of their implications, and finally, the charting of a course of operations, decisions and policies to take the fullest advantage of known facts and assumed events in order to reach the optimum objective.

Timing of formal plans must depend on the speed with which circumstances or cycles change and the degree of flexibility required. The important thing is to have a fixed timing for formal revision, because plans get out of date quickly and only a formal review will ensure that necessary revisions of policies and decisions are made promptly.

WHY PLANS FAIL

Six main reasons why planning programs fail, according to Michael J. Kami, director of long-range planning at IBM, are:

1. Failure to make decisions. Most crucial step in planning is implementation, which means decision-making; without it planning is a waste of time.

2. Too much reliance on committees. Their faults are magnified in planning because they are notoriously weak in making decisions. The result is compromise.

3. Too many planners separated from operations. Plans should be made by operating people who have facts and can make decisions. Staff planners should see that operators plan and should coordinate all parts into the over-all company plan.

4. Too much serial (sequential) planning. What's needed is parallel planning with each element making assumptions, using judgment, cross-checking and improving plans as more information becomes available.

5. Failure to put plans in writing. Written plans become commitments; this is vital to getting plans carried out.

6. Lack of support from top management. Without a top policy or directive of endorsement, planning flounders.

MECHANICS OF PLANNING

We now come to the specific steps to be taken in managerial planning, the "how-to" stage. First, there are two fundamental sets of information to be obtained, the external and the internal. Then there is the task of evaluating and collating the information, and finally, the presentation of the information in a form calculated to be helpful in determining the objectives and making the decisions needed to achieve them.

The external factors. Business is affected intimately by a great many factors beyond its control, such as the general level of prosperity in the country, access to foreign markets, tariff protection against imports, foreign exchange rate trends, general availability of money for capital, governmental regulations on products or merchandising, and many others. The study of these external factors is called economics, and the expert in the field is the economist. It is he who evaluates and estimates the effects of trends in gross national product, taxation and tariff policy, fiscal policy, and foreign trade movements, and political developments such as the European Common Market.

Among their other accomplishments, managers must also become economists of sorts. Some can afford to hire highly skilled economic specialists to advise them, but in the final analysis they must apply their own judgment to the collected facts and must make their own appraisals in reaching decisions for which they cannot delegate responsibility. Every company is affected by external factors, but the importance of these factors is far greater to some than to others.

A very great deal of information is constantly available on the external factors affecting business. The first basic source of information is statistics, provided for the most part by government, but coming right behind are the daily press, financial press, trade publications and a host of other sources.

External factors are having an ever-increasing influence on business. The world is splitting itself up into trading blocs. Tariffs, quotas, exchange regulations and other weapons are being used increasingly by foreign governments to influence world trade. Since a considerable part of gross national product in both the United States and Canada is directly involved in world trade, every company is concerned with these developments. No longer can we think and plan in terms of the local market alone. To succeed, the external factors must weigh heavily in our plans.

The internal factors. The internal factors, that is those within the control of management, include potential markets for present products, plant capacities, potential diversification into new businesses,

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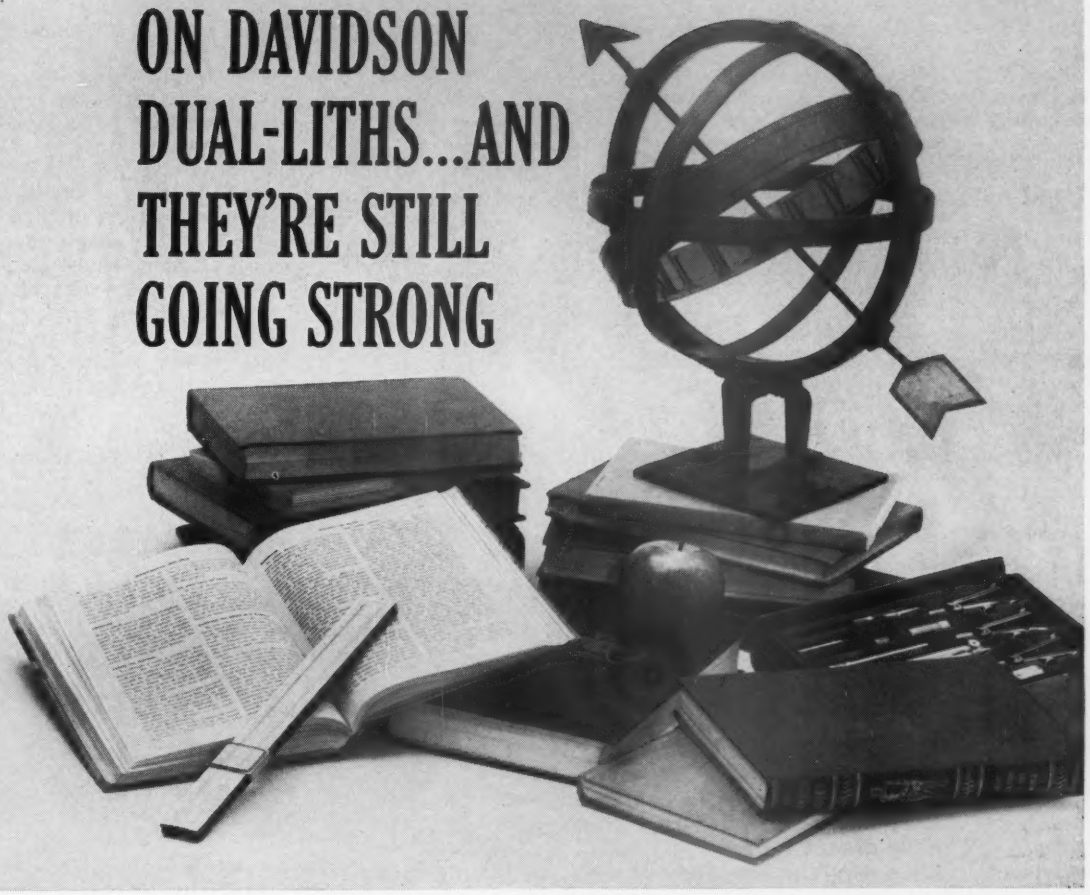

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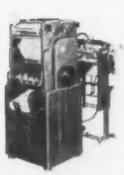

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raw material cost trends, wage rate trends, competitive situations and research objectives. In these areas information, whether factual or estimated, is obtained from department managers throughout the company. A certain degree of formality is useful in obtaining this kind of information, as it helps to ensure that all the useful information is forthcoming in a form which can be readily coordinated. The preparation of written reports with formal statements and charts helps operating managers to give more careful consideration to their forecasts and estimates, at the same time providing administrative management with facts in a more readable and more consistent form.

Evaluating and collating the factors. Having obtained all the information which can be useful in planning the future course of the company, the problem for administrative management is to sift the wheat from the chaff, retain only that information which is of real importance for planning purposes, then evaluate each specific piece of information. It is not sufficient to recognize that a certain fact is interesting; its effect on the company, either direct or potential, must be weighed in order to reach the decisions necessary to take full advantage of its potentialities.

In some companies this analysis and evaluation of information for planning is done by an individual or committee at the top-management level, but most often it is done as a staff function by the accounting staff. To make plans intelligible the assorted information must be expressed in a common language—dollars—so that it can be put together in the form of total results. All the market potentialities must finally be boiled down to a total figure for forecast sales, and all the diverse items entering into the production of goods must finally end up as a total cost of sales, before profit and return on investment can be calculated. Only when these are reached can there be a policy review with administrative management to determine what steps must be taken to improve results, reduce costs and expenses or diversify lines.

Thus, there is placed on the accounting staff a heavy responsibility to assess masses of information coming from operating management and from the economist and other specialists, to recognize the significance of each piece of information, to have a feel for the degree of optimism or pessimism that has been built in, and to estimate the degree of accuracy of the final results produced by all the information. The accounting staff must have a broad, if superficial, knowledge of all aspects of operations and external factors if it is to do a useful job in producing a consolidated draft plan for management consideration, and it needs the fullest support and understanding from the other departments.

The evaluation of information for planning presents unlimited scope for disagreement between the accounting and other departments. Everyone's goose is a swan, and accountants must strive to be impartial, factual and forthright in submitting their final assessment of the information for management action, even though they may be expressing unpopular views or interpretations.

The final planning document. The study of the consolidated report on planning information results in management decisions on the future course of action. Present policies may be confirmed, or changes may be found necessary to correct a fault or to take advantage of a new situation. Sales targets will be firmed up, cost and expense budgets can be fixed, salary and wage rate policies established. The effect of forecast operating results on the company's financial position will be shown, so that decisions can be taken on dividend policy, plant expansion, new capital needs and sources, inventory management and the other balance sheet items. Then, after all decisions have been made and there is top management agreement on the planned course for the future, the final plan document can be prepared for directors.

This document may be in one of a variety of forms. It is, however, important to bear in mind that, if the objective is to be reached, each management level must know enough of the plan and its aims to make the day-to-day decisions calculated to keep their units in line with the total objective.

CONCLUSION

Planning consists of collecting all the pertinent data, both internal and external, making reasonable assumptions on future developments based on present and past facts, and evaluating the information and assumptions objectively, without bias.

The man, or the company, who plans ahead rather than proceeding blindly by intuition is most likely to succeed in the long run. Policies must be formulated, decisions made on the course to follow and limits for costs and expenses established; financial needs must be determined, with new capital needs being defined and sources of capital decided. Sufficient information must be given on the plan to all levels of management to enable them to operate according to the long-range objective.

Dates Ahead

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MAY 15-17	INSTITUTE OF NEWSPAPER CONTROLLERS AND FINANCE OFFICERS National Spring Conference	NASHVILLE, TENN.
MAY 22-24	CONTROLLERS INSTITUTE OF AMERICA North Central Conference	LOUISVILLE, KY.
MAY 22-26	NATIONAL OFFICE MANAGEMENT ASSOCIATION 41st International Conference	MONTREAL, QUE.
MAY 31-JUNE 3	NATIONAL RETAIL MERCHANTS ASSOCIATION 40th Annual Controllers Congress Convention	CHICAGO
JUNE 9-11	CONTROLLERS INSTITUTE OF AMERICA Midwestern Conference	MILWAUKEE
JUNE 22-24	NATIONAL MACHINE ACCOUNTANTS ASSOCIATION National Conference and Business Show	SAN FRANCISCO
AUGUST 28-SEPT. 1	TAX EXECUTIVES INSTITUTE	WHITE SULPHUR SPRINGS, W. VA.
OCTOBER 10-12	NABAC, The Association for Bank Audit, Control and Operation 36th Annual National Convention	LOS ANGELES
OCTOBER 10-12	SYSTEMS AND PROCEDURES ASSOCIATION International Systems Meeting	NEW YORK
OCTOBER 19-22	AMERICAN RECORDS MANAGEMENT ASSOCIATION Annual Convention and Records Management Workshop	MILWAUKEE
OCTOBER 22-26	CONTROLLERS INSTITUTE OF AMERICA (Western) 29th Annual Conference	SAN FRANCISCO

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Winning Tax Savings from Bad Debts

Donald F. Dvorak

Deciding on how best to report bad debt losses in paying the federal income tax

IN TODAY'S UP-AND-DOWN ECONOMY the unwary corporation faces a lurking tax disaster through unimaginative handling of its bad debts. All too often the controller is content to relegate the problem of bad debts to the exclusive domain of the credit manager, making only perfunctory audit checks now and then, but otherwise disassociating himself as much as possible from the whole matter. That this approach can be extremely dangerous becomes evident when one realizes the critical interrelationship of bad debts and federal income taxes.

We are all aware, of course, that there are two basic accounting treatments of bad debts. One method is known as the "specific charge-off" and the other is called the "reserve method."[1] Under the specific charge-off method, bad debts are recognized in the period when the accounts are determined to be uncollectible. This method has simplicity and general ease of handling as its prime virtues. No problems of estimating the expected losses are encountered. The accounts are charged off directly to expense and any recoveries are reported as income.

The reserve method recognizes bad debt losses in the same year that sales are made. This method is more involved, since a new account called a reserve or allowance is created to indicate the estimated amount of uncollectible accounts. The estimate of current year uncollectibles is credited to this account and charged to expense. Conversely, when a customer's balance actually becomes uncollectible, it is charged against the reserve. Recoveries are properly credited to the reserve instead of being reported as income. Financial statement presentation requires that the reserve be shown in the balance sheet as a deduction from the accounts and notes receivable to which it applies.

Accounting theory would tend to offer greater justification for use of the reserve method, since that method has the effect of matching bad debt losses more closely with related revenues than does the specific charge-off method. Furthermore, balance sheet presentation is better, in that accounts receivable are less likely to be overstated.

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Perhaps the most difficult problem involved in the use of the reserve method is the computation of the estimate of bad debt losses relative to current revenues. Several methods are in use. One accounting text lists four as being representative.[2] They are as follows (italics supplied):

1. Application to net sales of a percentage based on the past relationship between *experienced bad debts* and *net sales.*
2. Application to the total of the credit sales for the period of a percentage based on the past relationship between *experienced bad debts* and *credit sales.*
3. Application to the outstanding accounts receivable balance of a percentage based on the experienced past relationship between bad debts and the *end-of-the-period* outstanding *accounts receivable.*
4. Bringing the balance in the contra allowance account up to an amount equal to the results determined by *analyzing the aged accounts receivable.*

From the viewpoint of good accounting theory, none of the above methods can be considered an absolute best answer to the problem. The first two emphasize the matching of loss against revenue and give the lesser consideration to the problems of the balance sheet. Conversely, the last two tend to show a better picture of the collectibility of open accounts with a lesser regard for the income statement. These difficulties of estimating bad debts can only be resolved by analyzing the problems of a particular industry and company to determine which method is most adaptable to the objective situation.

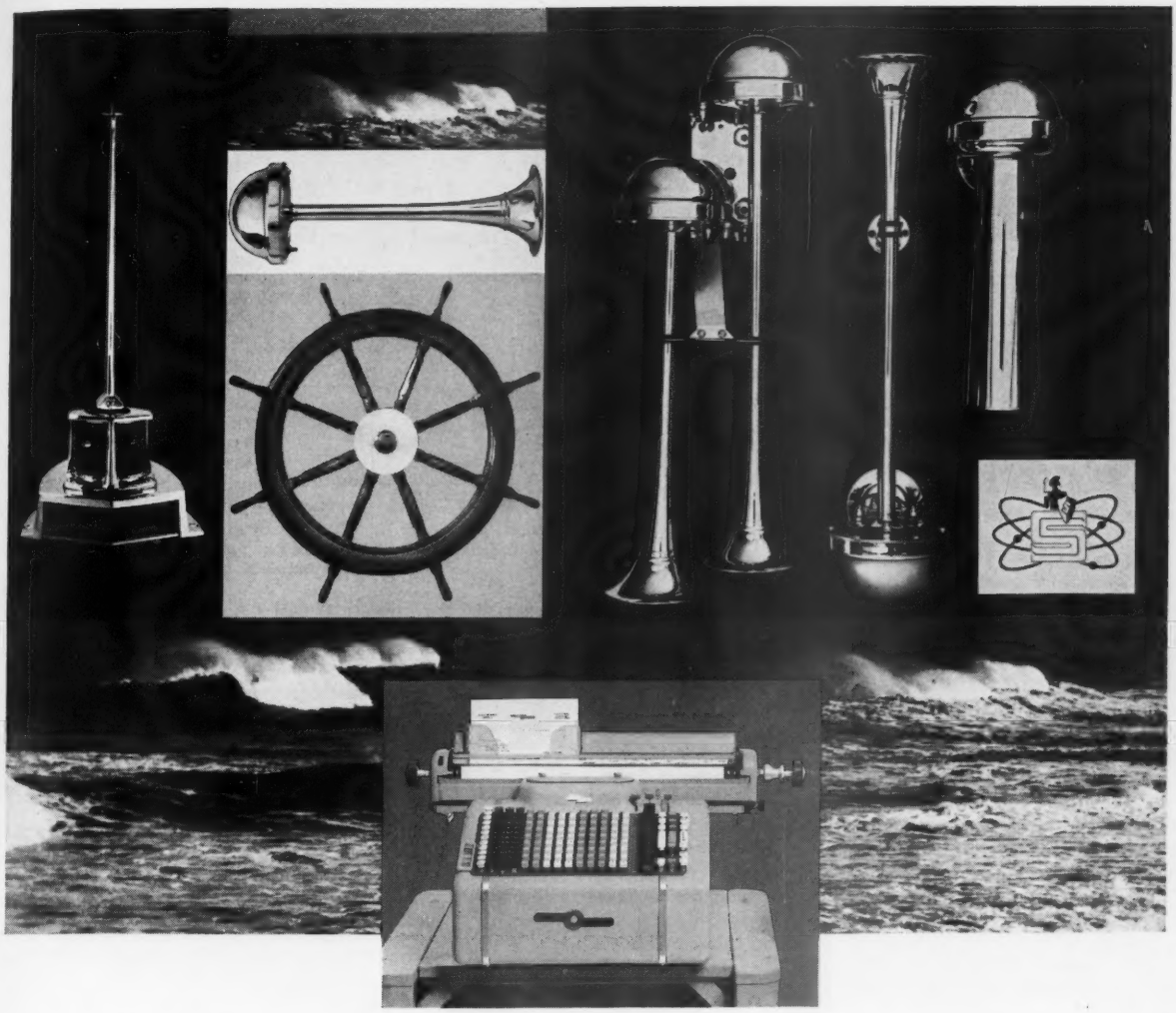
TAX CONSIDERATIONS

Any study of the problems of the allowable tax deduction for business bad debts must also begin with the two methods of accounting discussed above, since they are prescribed by Act of Congress in Section 166 of the Internal Revenue Code. In an initial return, the taxpayer may elect to use either method, subject to the Commissioner's approval. Thereafter the same method must be used for subsequent years unless the Commissioner's permission to change is obtained, pursuant to the taxpayer's application.

If the specific charge-off method is chosen for the initial return, a deduction may be taken for the amount of the adjusted basis of a bad account only in the year that the debt becomes wholly worthless or, when partially worthless, only to the extent charged off in that year. According to the regulations, worthlessness is a fact which the taxpayer has the burden of proving from the surrounding circumstances. Worthlessness is evidenced, say the regulations, by the fact that legal action to obtain payment would result in an uncollectible judgment. Settlement in

[1] Various other descriptive titles are used and recommended for these methods, but for our purposes the above uses are sufficient.

[2] *Accountants' Handbook,* Fourth Edition, The Ronald Press Company, 1956, Chapter 11, page 25.



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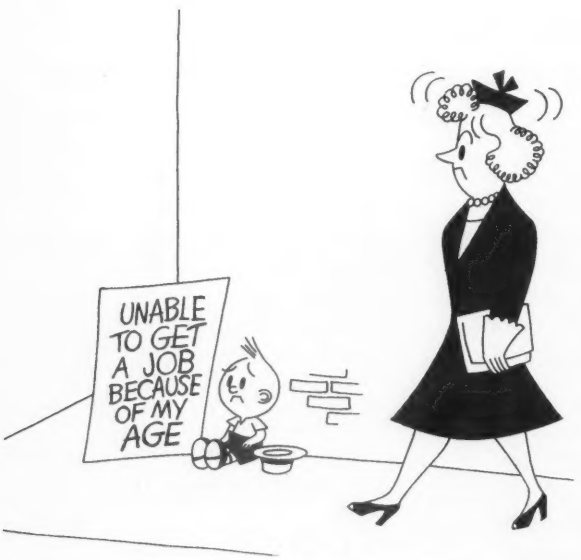
bankruptcy may also indicate worthlessness, although worthlessness can be determined before settlement in bankruptcy.

Thus, the specific charge-off method can present certain difficulties in determining the precise year in which a debt becomes wholly or partially worthless and thereby deductible. The taxpayer may protect himself against this problem by claiming a deduction in any year in which the debt could possibly be held to be worthless. Such claims can be made either by deducting the bad debt on the tax return or by filing a claim for refund within the special seven-year statute applicable to refund claims involving bad debts losses. In all cases, the books should reflect a charge-off in case the Treasury allows only a partial bad debt.

If the taxpayer elects and the Commissioner approves the use of the reserve method on the initial return, the law allows, "within the discretion of the Commissioner, a deduction for a reasonable addition to the reserve for bad debts." The controlling factor is not whether the additions to the reserve are sufficient to absorb the bad debt losses that might arise but whether the reserve itself is sufficient for that purpose. Generaliy, the Commissioner will approve the use of the reserve method for "taxpayers having a large number of accounts where credit has been extended to cover a considerable period of time." Approval "is not granted for the purpose of handling one specific bad debt."[3]

As one would expect, the problem in utilizing the reserve method for tax purposes rests in the questions *"What is a reasonable addition?"* and *"Has the Commissioner properly used his discretion?"* In both areas the "heavy burden" of proof is on the taxpayer since the Commissioner's determination is *prima facie* correct.[4] As to the first question, the regulations under the 1954 Code provide that a reasonable addition "shall be determined in the light of the facts—and will vary as between classes of business and with conditions of business prosperity. It will depend primarily upon the total amount of debts outstanding as of the close of the taxable year, including those arising currently as well as those arising in prior taxable years, and the total amount of the existing reserve. In case subsequent realizations upon outstanding debts prove to be more or less than estimated at the time of the creation of the existing reserve, the amount of the excess or inadequacy in the existing reserve should be reflected in the determination of the reasonable addition necessary in the taxable year."[5]



THE BLACK MOTOR COMPANY DECISION

Although the definition of the term "reasonable addition" provided by the proposed regulations is not precise, litigation on this issue adds some clarification. The leading case from which the Commissioner derives most of his practical criteria for judging the reasonableness of reserve additions involved the Black Motor Company, Inc.[6] Here the Commissioner successfully disallowed $12,270 as an excess addition to the bad debt reserve for the year under review. The method of computation he employed may be illustrated as follows:

Year	*December 31 accounts and notes receivable*	*Net bad debts*	*Per cent of losses*
19-1	$105,082	$ 24,801	23.60
2	67,900	15,527	22.87
3	56,040	21,133	37.71
4	71,119	27,477	38.63
5	98,958	34,333	34.69
6 (under review)	174,021	60,920	35.01
Total	$573,120	$184,191	32.13

Accounts and notes receivable December 31, 19-6	$174,021
Reserve balance as adjusted at December 31, 19-6 (32.13% of $174,021)	$ 55,913
Add: Net losses charged to reserve for year	60,920
Total reserve requirement	$116,833
Deduct: Reserve balance at December 19-5 (assumed to be allowable)	37,500
Allowable addition to reserve for year	$ 79,333
Deduction per return filed	91,603
Excessive addition disallowed	$ 12,270

The Court stated in its opinion that the formula used in the Black Motor Company case was not a final answer as to what constituted a reasonable addition. It pointed out that "the test is whether the amount ultimately determined, regardless of formula, constituted a reasonable addition to the petitioner's reserve. What constitutes a reasonable addition will depend upon the facts and circumstances of the business engaged in with relation to general business conditions. A method or formula that produces a reasonable addition to a bad debt reserve in one year, or a series of years, may be entirely out of tune with the circumstances for the year involved."

The Court enunciated a similar dictum in its decision on the S. W. Coe & Co. case,[7] but here it emphasized the taxpayer's burden of proof. The Commissioner had employed the Black Motor Company formula and the taxpayer argued that there was no justification in the statutes or regulations for controlling additions to a bad debt reserve "by a rigid arithmetic formula purely retrospect in its effect." The taxpayer asserted that "the function of a reserve for bad debts is to protect against excessive losses in future depression years." The Court in this decision agreed "that a slavish adherence to a formula might, under certain circumstances, result in an unreasonable addition to a bad debt reserve, or a failure to make any addition"; however, it concluded that this was not true here, since the taxpayer had failed to show the Commissioner's computations to be unreasonable or an abuse of his discretion. Furthermore, the Court indicated that although it may be wise business management to accumulate surplus funds against future contingencies, such reserve additions were not contemplated by the statute and therefore "are not allowable as a deduction for a bad debt reserve."

In spite of the fact that the Black Motor Company formula

[3] I.T. 1644; CB II-1, 99.
[4] *Maverick-Clarke Litho. Co.*, 50-1 USTC 19227.
[5] Regulations 1.166-4.
[6] *Black Motor Company, Inc.*, 41 BTA 300.
[7] S. W. Coe & Co., 54-2 USTC, 9667.

should not of itself provide the only answer as to what is a reasonable addition to a reserve for bad debts, the Commissioner and his agents have consistently employed it as a measuring stick in the vast majority of examinations concerning bad debt reserves. When significant variances between the taxpayer's computations and the formula exist, the agent will unquestionably attempt to disallow any deductions over the amounts computed by using the formula. The taxpayer will then have the rather difficult task of proving the results of the formula to be unreasonable and an abuse of the discretion of the Commissioner.

Thus it seems clear that the results of any method used by the taxpayer should be periodically tested against the results of the Commissioner's "measuring stick." Large variances between the two methods must be discouraged unless unquestionably justified.

ALLOWED FORMULAS FOR BANKS

Under a series of rulings, the Commissioner has allowed commercial banks to use a special formula to compute additions to a reserve for bad debts. Mimeograph 6209 as extended by Revenue Ruling 54-148 allows the use of a 20-year moving average of the ratio of bad debt losses to year-end outstanding loans in computing the current year reserve addition. In no case, however, may the balance of the reserve exceed an amount which is three times the average annual addition. Thus, in practice, the annual addition may be substantially limited or not allowed at all.

For example, assume an average 20-year loss rate of nine-tenths of one per cent, current year-end loans outstanding of $1 million, an opening reserve balance of $30,000 and actual bad debts charged off of $2,000. The allowable addition in this example would be zero, computed as follows:

Reserve limit (.9% x $1,000,000) x 3		$27,000
Less: Opening balance of reserve	$30,000	
Current year charges	2,000	
		28,000
Addition allowed		$ 0

Commercial banks may choose one of two periods over which the average loss ratio is to be computed. They may either select the 20 consecutive years ending with, and including, the current year; or, they may choose any 20 consecutive years beginning after 1927. If the bank was not in existence during the full 20 years, the Internal Revenue Service permits use of the loss experience of other banks based on Federal Reserve data.

A SUGGESTED FORMULA

As we have seen, most formulas in use today estimate an addition to the reserve for bad debts based on simple arithmetical averaging techniques. Accordingly, these methods can give no special recognition to changing trends in bad debts. In our opinion, such recognition would be extremely meaningful, since the reserve addition for each year purports to be a *forecast* of uncollectibility. If we give the same emphasis to current as well as past year bad debt losses, we tend to assert a forecast of "no change."

One possible solution to this problem of forecasting would be the use of a *weighted average*. Here the more current years could be given larger weight factors while the earlier years would have less emphasis. The actual weights to be used in any given situation could not be suggested here except to the extent that they are the result of a well-planned objective analysis. However, we can illustrate the use of the technique with the facts given in the Black Motor Company case discussed above. For the purposes of this example, we will assume that the six years are given weights from six to one, respectively, with the latest year taking the largest weight factor.

Year	Weight factors	December 31 accounts and notes receivable		Net bad debts	
		Actual	Weighted	Actual	Weighted
19-1	1	$105,082	105,082	24,801	24,801
19-2	2	67,900	135,800	15,527	31,054
19-3	3	56,040	168,120	21,133	62,399
19-4	4	71,119	284,476	27,477	109,908
19-5	5	98,958	494,790	34,333	171,665
19-6	6	174,021	1,044,126	60,920	366,520
		$573,120	2,232,394	184,191	766,347

Six-year average ratio of losses to year-end receivables	32.13%
Six-year weighted average ratio of losses to year-end receivables	34.33%
Increase of ratio by using weighted average	2.20%
Accounts and notes receivable, December 31, 19-6	$174,021
Possible increase in addition to reserve	$ 3,828

Although we know of no case where a weighted average method has been used either by the taxpayer or Commissioner, it is not inconceivable that an addition computed under this method would be allowed by the Commissioner. Certainly, it is similar to the formula presently employed by revenue agents in that it is based on the outstanding receivables at year-end. Moreover, it can be as beneficial to the Commissioner as to the taxpayer; for if the trend of bad debts is downward in current years, the weighted average ratio will be lower than a simple arithmetic average. For example, if in the above illustration the year 19-1 were the latest year and 19-6 the first year, the weighted average would be 24.76 per cent or 7.37 per cent below the arithmetic average. Because of this double-edged effect some taxpayers might prefer to ignore this method even if it were allowed, since the Commissioner would undoubtedly require that the taxpayer continue to use this method for all years. It should be noted here that if this method were approved, in the year of a change from the specific charge-off to the reserve method, the extra deduction discussed below might be significantly increased.

CHANGING METHODS—ADVANTAGES

A taxpayer using one method of accounting may frequently receive tax advantages by shifting to the other method. Usually this happens when the taxpayer changes from the specific charge-off to the reserve method.

In order to make the change, it is necessary to request and receive permission from the Commissioner, but usually this does not present any particular problem. According to the latest available information,[8] the requesting taxpayer need only send a letter to the Commissioner stating his name and address, the method of accounting employed, the method of deducting bad debts presently followed, the method to which the taxpayer desires to change and the year to which the new method will first apply.[9]

A reason for the change is not absolutely required, but is clearly desirable. For example, two reasons that are used frequently to support requests for permission to change to the reserve method are as follows:

1. Taxpayer desires to make the change so that income for federal income tax purposes may more closely conform to income as determined in the corporation's accounts.

[8] Information based on several approved requests for changes occurring in 1958.

[9] For taxable years beginning after December 31, 1959, the request must be filed within 90 days after the beginning of the year. For a fiscal year which ends in 1960 and began before December 31, 1959, the request must be filed 30 days in advance of the close of the year.

2. The change is requested because of changing economic conditions whereby large losses have been experienced in recent years, and more can be expected in the future. In view of the greatly enlarged potential loss possibilities in accounts receivable, taxpayer deems it necessary to change to the reserve method in order to reflect net taxable income properly by annual accounting periods.

The facts necessary to substantiate the first of these reasons may be created by the taxpayer by simply establishing a book reserve that is not used for tax purposes. This may be wise tax planning for new corporations in anticipation of future change to the reserve method for tax purposes, for here they have a continuing reason supporting the change.

A primary advantage accompanying a shift to the reserve method occurs in the year of change. Here the combination of the charge-offs for debts created in prior years and a reasonable addition to the newly created reserve will produce an abnormally large single deduction. In short, both the debts charged off plus a reasonable addition to the reserve will be deductible. The following example illustrates the computation of this unusual deduction.

P Corporation uses the specific charge-off method to account for bad debts. For the present and preceding five years it sustained a total of $66,800 in net bad debts which was written off. The net bad debts for the current year was $6,400 and ending balance of trade accounts receivable is $250,000. A cumulative total of year-end accounts receivable balances for the last six years is $1.67 million. If the P Corporation shifts to the reserve method in the present year, it would be entitled to a year-end reserve balance of $10,000 and a total deduction of $16,400 computed as shown in next column.

This special tax advantage exists, of course, in the initial year only and, although it may be considered a "distortion of the net income for the year,"[10] it is in keeping with controlling legislation and rulings. Accordingly, auditors and management must be keenly aware of this possibility of tax savings for companies that are not on the reserve basis but do sustain consistently large bad debts each year. In our example, the P Corporation could ordinarily save $5,200 in taxes upon switching to the reserve method.

Net bad debts (6 years)	$ 66,800
Total year-end balance of receivables (6 years)	$1,670,000
Ratio	4%
Current year-end balance of receivables	$ 250,000
Allowable reserve balance at year-end	$ 10,000
Add: Net bad debt losses written off	6,400
Allowable addition to reserve and deduction for changeover year	$ 16,400

DIVIDEND RECEIVED DEDUCTION

There are situations when use of this first year extra deduction could result in more subtle and far-reaching tax advantages than a simple 52 per cent reduction of tax. One such possibility involves the limitation on the 85 per cent dividend received deduction.

Under Section 246 of the Code, a limitation applies to a dividend received deduction when 85 per cent of the taxable income is less than 85 per cent of the qualifying domestic dividends received by a corporation. In such a case the lesser figure must be used in computing taxable income and a valuable deduction is lost. This limitation is subject to one exception; that is, no limitation will apply if removal of the limit serves either to create a net operating loss or increase an existing loss. Here, the extra deduction allowed in changing to the reserve method

[10] *Bennie Rudner*, 47 BTA 35.

may serve as a device to avoid partial loss of a dividend received deduction. The following example illustrates this point:

	19-1 Without change	*19-1 With change to reserve method*
Taxable income (before dividends received deduction and reserve provision)	$170,001	$170,001
Reserve provision for bad debts		(10,000)
Taxable income (before dividends received deduction)	$170,001	$160,001
Domestic qualifying dividends received—$200,000		
Dividends received deduction:		
85% X $170,001	144,501	
85% X $200,000		170,000
Taxable income (loss)	$ 25,500	$ (9,999)

Accordingly, prudent tax analysis could save the corporation $7,760 in taxes in the year of change to the reserve method. Furthermore, if the loss created by changing to the reserve method were carried back and a full 52 per cent tax refund realized, the total savings in tax would be $12,960 ($7,760 plus $5,200). This tax savings would be almost 30 per cent more than the bad debt deduction itself, and again without the additional expenditure of any corporate funds.

DISADVANTAGES OF THE RESERVE METHOD

Although there is no outstanding disadvantage in using the reserve method, two situations come to mind when use of the reserve method may not be beneficial. First, the taxpayer must remember that when all reason for maintaining a bad debt reserve ceases, the reserve then becomes an item of gross income. For example, when a taxpayer using the reserve method goes out of business, the amount of the reserve is probably includible as income on the final return.[11] Secondly, if the taxpayer attempts to return from the reserve method to the specific charge-off method, the Commissioner has ruled that as a condition to the right to make the change, the taxpayer must include in gross income an amount equal to the reserve for bad debts as of the end of the year previous to the one in which a change occurs.[12]

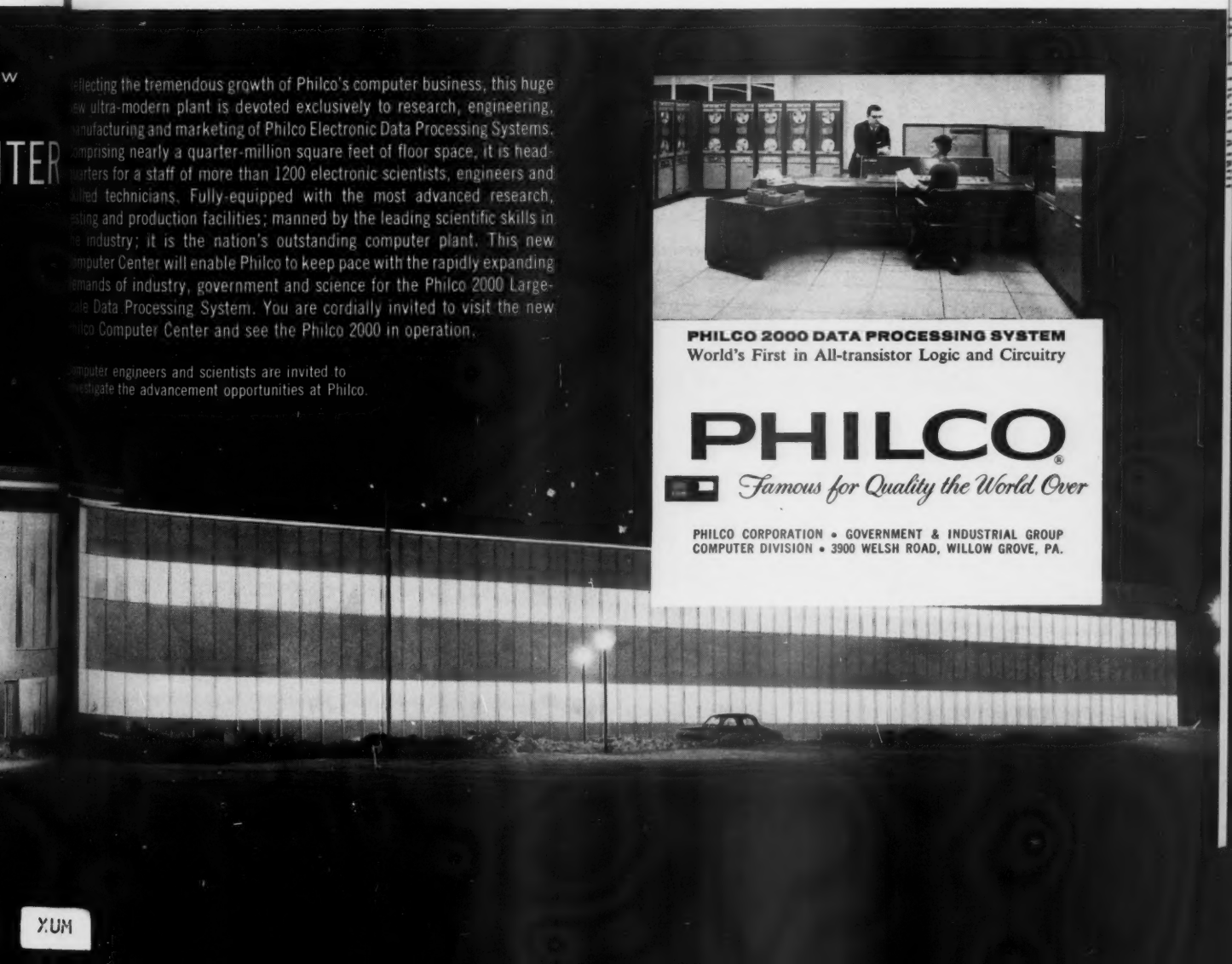
THE CONTROLLER'S TASK

In view of the opportunities for tax savings, both in the year of a change to the reserve method and in the mere avoidance of disallowances of bad debt deductions, the controller should remain alert to vital tax considerations when reviewing the accounting for bad debt losses. In a typical case, he should:

1. Know which method of accounting for bad debts is in use.
2. Determine the bad debt experience of the corporation for the last six years.
3. If the corporation uses the specific charge-off method, consider changing to the reserve method, and thereby reap a permanent tax savings.
4. If the corporation uses the reserve method, test the desired addition in any given year against the addition allowable under the Black Motor Company formula. If the formula results in a significantly lower addition than otherwise desired, use the higher figure as an addition only if it can be justified by other analytical techniques. If, however, the results of the formula computations indicate a greater addition than otherwise contemplated, consider increasing the amount of the addition to that allowed by the formula.

The above is a minimum list of tax considerations of which the controller should be aware. Certainly anything less overlooks the critical interrelationship of bad debts and taxes.

[11] Rev. Rul. 57-482, 1957-2, CB 49.
[12] IT 2348, CB VI-1, p. 67, modified by IT 1744, CB II-2, p. 179.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EDP from "Shake-down" to "Pay-off"

R. B. Curry
Vice President and Comptroller
Southern Railway System
Washington, D. C.

IN THE LAST HALF DOZEN YEARS, the electronic computer has come to commerce from its former exclusive province of scientific and military utilization. In this period, management effort, totaling thousands of man-years, has been expended in the application of this new tool to a multiplicity of complex as well as routine tasks in diversified business fields, including most notably manufacturing, insurance, public utilities and transportation. The time and attention of corporate officers has been necessarily focused on the cost and the direction of this development.

Responsively and simultaneously as this development was occurring, Controllers Institute, through its Research Foundation, published studies, reports and other informative materials as to its progress. Most lately the Institute has published a synthesis of the knowledge gained by the companies earliest in electronic data processing, to enable their experiences to serve as a guide for others presently concerned with "first steps." This text,* prepared by the staff members of Price Waterhouse & Co., is primarily for those assigned the decision-making in the acquisition of a computer and for those responsible for putting an EDP system "on the air," and keeping it there.

The authors followed a scientific course and achieved a scholarly result. Taking the experiences of a necessarily limited number of companies and drawing on experiences of their staff members, they accumulated examples and weighed evidence, sounded out the veterans (if six years make a veteran), and came up with a comprehensive and analytical coverage of the problem areas in converting business procedures and clerical work into computer processing.

The book is distinctive in that it is not a theoretical treatment of EDP as have been so many writings. Moreover it is based upon a composite of the cumulative experience of people having actually installed and directed commercial computer systems through the "shake-down" stage and into "pay-off" operations. They have avoided the company case method with its inherent faults of generalization from the particular. It is highly recommended as an authentic, informative and extremely readable text.

The central theme of the text is *"What has been learned?"* and the phrase aptly precedes chapter headings which are:

What has been learned about
- Making the decision
- Preparing for and introducing electronic equipment
  - Company education and the company programming group
  - Development of the application and conversion from prior methods
- Operating electronic equipment
- Relations with the manufacturer

The concluding section—some unresolved matters and some thoughts on the next five years—introduces an element of timeliness which makes the text valuable to those already converted to EDP as well as those just starting.

The book will be appreciated by earlier computer users for its presentation of concrete experiences in

Up-grading EDP equipment
- The transition problems in moving to computers of greater capacity

* *Business Experience with Electronic Computers*, B. Conway, J. Gibbons, and D. E. Watts. Controllers Institute Research Foundation, Inc., Two Park Avenue, New York 16, N. Y. $5.00.

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Up-grading and up-dating EDP programs

Problems of adopting newer techniques in automatic coding; problems in maintenance programming; alternate possibilities in organization; assigning and supervising programmers

Only at infrequent intervals would one say that the computer jargon becomes too technical and never for so long that the generalist can not follow.

Costs and relative merits of specific equipment are gratifyingly missing, but the aspects of equipment selection are well covered. While relatively slight concern has been given to selection and preparation of a computer site, principal phases of installing an EDP system have been presented.

In any such presentation, there are propositions stated and conclusions drawn with which issue can be rightly taken. This reviewer would have several basic disagreements. For example, he would have been happier with greater recognition of the personal equation. Here the personal factor, as such, has not been recognized except indirectly in the continued emphasis that success or failure depends on correct decisions and adequate planning. While factors other than leadership and supervision are involved, the difference between computer success and otherwise has been recently described —"For one user it will perform wonders, for another it may not even pay for its keep. Everything depends on how skillfully it is used." "The War of Computers" by Frank Bello. (*Fortune*, October 1959.)

On a number of less fundamental questions one could differ from the reporting or conclusions; for instance, it can be shown that companies can and have developed programming proficiencies on their staffs equal or comparable to the professional attainment of the programming group of the manufacturer.

Veterans will have their particular and healthy differences of opinion with the authors and with the reviewer, but will agree that the book is an erudite and encyclopedic exposition of the subject as stated. Some may be critical of the detail. However, this is an informative reference text bordering on the handbook category, and while some have been quite successful with much less detailed planning than suggested, minute attention to detail may well mean the difference between success and failure for others.

Bookshelves now bulge with material on the subject of EDP but few have achieved the status warranted by the authentic content of this book. Controllers Institute should provide for continued revision and up-dating as a standard reference.

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Taming the Advertising Budget

A way to keep track of $3 million in small outlays

CONTROLLERS and advertising managers in nearly all companies face this problem: *How can we keep track of expenditures, month by month, and by the various categories, in the advertising department?* Total advertising expenditures are large but individual items in this budget are comparatively small. For this reason, time-consuming recordkeeping is required to supply company executives periodically with indispensable reports on advertising expenditures.

* * *

Up to 1955, Royal McBee was somewhat in the situation of a preacher who does not follow his own preaching. For a major function of Royal McBee's Advertising Department has been to urge American business to use Keysort cards to process data on various aspects of operations. At the same time, ironically, Royal McBee did not use Keysort cards for its own processing of advertising expenditures.

But approximately five years ago, it occurred to someone at Royal McBee that the Keysort system could be utilized advantageously in controlling the advertising budget. So it has proved. The control operation was entrusted to an advertising assistant whose function is to maintain the advertising budget control system. The advertising budget is broken down to two major divisions: Typewriter and the data-processing division.

In the typewriter division advertising budget, expenses are allocated to the following departments: Standard typewriter, electrical typewriter, portable, typewriter supplies, and two school departments. In the other division, data processing, advertising expenditures are allocated to these two departments: Keysort and the LGP-30 electronic computer. For each product a budget has been set up for all expenses. Thus, in a typical budget, funds are allocated for such expenses as art and mechanical, TV commercials, display, literature, publicity, and many other categories.

THE BREAKDOWN OF SPENDING

Each month, the advertising assistant prepares a report which shows, for each product, a breakdown of spending by expense category. To facilitate the making of meaningful comparisons, this report shows, for each category, the appropriation, expense year to date, spending in the latest month, open commitments, and the balance of the appropriation that is still available for spending. By "open commitment" is meant the money that is being spent on advertising activities that have been ordered but are not yet completed or paid for. But, of course, this money has already been set aside and is no longer available for future spending.

Until the current system was adopted by the Advertising Department, the preparation of these monthly reports was extremely difficult. The segregation of expense items by the various categories appearing in the two advertising budgets required endless hours. The advertising manager could not readily obtain special reports during the month which showed the status of the budget for specific expense categories.

THE PUNCHED CARD SYSTEM

The installation of the punched-card system has simplified this entire task. At present, the cards are used to record the pertinent information on all advertising jobs. Each department as well as each type of expense has its own code symbol. When an expense is to be charged to display, for example, the hole representing "2A" is notched. Thus, subsequently, if the advertising assistant wants to get the total of expenditures for display during the month just ended all he has to do is to insert the stylus, or sorting needle, into a batch of cards. All cards that are notched in the corresponding hole will fall away from the stylus.

The first step in this system is to give a number to each job. The production manager of the advertising department asks the assistant for a job number when he is initiating a project. This number is notched on the card. The necessary information is pencilled on the card by the production manager. He also fills out, in pencil, a blue order form. The card and the blue form are turned over to the advertising assistant who sends the latter to the Accounting Department at the firm's headquarters where the information is typed in. The blue form is returned to the Advertising Department. A blue form is sent to the supplier or vendor.

Cards representing the purchase of space are not given job numbers because of the frequent changes in schedules. Instead, the two advertising agencies handling the various products prepare schedules of advertising which are okayed by the director of advertising.

BLUE GRASS

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MAY 21-24, 1960 KENTUCKY HOTEL, LOUISVILLE, KENTUCKY

The advertising assistant notches the cards in the appropriate categories. All cards are handled in numerical sequence except, of course, the space cards which are kept together in a group. After the job has been completed and the bill from the supplier has been received, the job number is written on the bill. The assistant notches the "paid" hole on the card representing the particular job. The blue form is attached to the invoice which is approved by the advertising assistant. These papers are then routed to the director of advertising who okays them for payment by the Accounting Department. The punched card, which remains with the advertising assistant, is then placed by him in the "current month" file.

As stated earlier, a total of expenditures for each category and department is prepared at the end of the month by the advertising assistant. All cards for each department are classified by expense category and totals for each expense category are run on the adding machine. The reports are then submitted to sales department executives.

To make certain that his reports are correct, the assistant checks the accuracy of his reports every two or three months. In this way, he attempts to achieve a reconciliation of the various figures in the reports.

A BY-PRODUCT

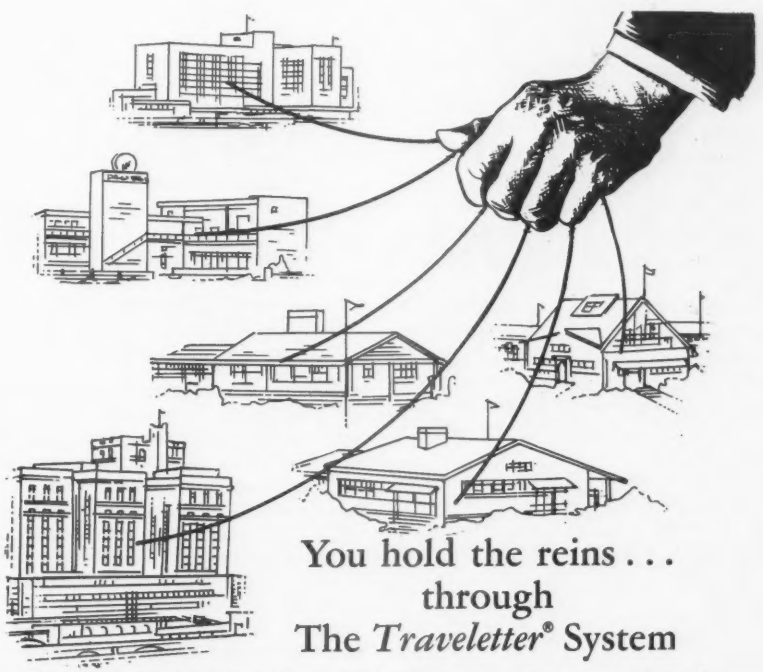
As a by-product of the budget controls, there are a number of other advantages derived from the operation of this system. For example, if the firm doing art work for a brochure calls to find out why it has not received payment, the advertising assistant looks up the blue order form and checks the purchase order number. He also determines whether he has okayed the particular job for payment.

All pieces of advertising literature have the code number on the last page. If, for example, the advertising department wants to reprint the brochure, the card relating to the particular job is quickly located. Vendor, purchase order number, and other pertinent data are ascertained from the card. This information is useful in negotiating for the reorder of the job.

According to the advertising manager, the budget control system has proved to be of great value in checking advertising expenditures for the various categories and departments. "Without this procedure," he declared, "we were unable to learn promptly what the status of the budget was. Previously, it was difficult to keep track of a $3 million advertising budget. I wonder what companies with larger budgets do if they don't have a system similar to our procedure in controlling advertising expenditures."

CHANGING YOUR ADDRESS?

Notice of change of address for THE CONTROLLER should be received in the editorial offices of THE CONTROLLER, Two Park Avenue, New York 16, N. Y., before the first of the month to affect the following month's issue. For instance, if you desire the address changed for your July issue, we should be notified of your new address before June 1. *Be sure to include your postal zone as well as your old and new address.*



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Paging the New Books

THE RED EXECUTIVE*

by David Granick

Reviewed by HERMAN W. STEIN
Vice president and controller
A. C. Nielsen Company
Chicago, Ill.

How much do we really know about the present status of industrial development in the Soviet Union?

To what extent is our current image of the Soviet competitive threat distorted by long-standing impressions of Russian backwardness, and perhaps even more significantly, by our innate objections to its political philosophy and its accompanying excesses?

Developments of recent years suggest that a factual appraisal of the Russian industrial scene is essential for those concerned with our own industrial progress.

Are these developments lucky "stabs in the dark" or do they portend a trend? If the latter, where does the trend lead and how does it compare with our own?

Such a study should be undertaken unemotionally and with the utmost objectivity. This is what the author seems to have set out to do in this book.

Dr. Granick is currently completing a year at the University of Glasgow, on a Fulbright grant, and will become associate professor of Economics at the University of Wisconsin this fall. His work in the field of Soviet economics and management has been widely recognized. It gave him unique preparation for his visit to the U.S.S.R. in the summer of 1958 for firsthand observations with which to complete the thorough research on which the book is based. This reviewer has found nothing in Dr. Granick's observations that is in any way at odds with his own, admittedly much more limited, observations in a recent tour of nearly a month in the U.S.S.R.

The book is very well structured, both for consecutive reading as well as for reference in connection with subsequent reading on related subjects. Included are such intriguing chapter heads as:

TRUTHS AND CANARDS
COLLEGE EDUCATION
STANDARD OF LIVING
BUREAUCRACY AND HOW TO LIVE WITH IT
STOCKHOLDERS AND THE COMMUNIST PARTY
RUNNING THE FACTORY
ECONOMIC COMPETITION
RATE OF GROWTH, etc.

Basic to remember in any consideration of Russian industry is that the Communist party (representing the people) is the owner of all enterprise and the party presumably does represent the people, although out of a population total of some 200 million people, only about eight million are members of the Communist party. One of the author's arresting comparisons is given in a chart labeled "Levels of Power." Therein he depicts the party members as the counterpart of the stockholders in our corporations. The Presidium, consisting of 14 members with Khrushchev as chairman, is the top echelon of authority, the counterpart of our board of directors. Our chief executive officers are shown on the same level as the Council of Ministers in the Soviet.

Soviet industrial enterprises have a plant manager and what by our standards would be a normal complement of top-, intermediate-, and lower-level management and supervisory personnel—both line and staff. It is interesting, but not surprising, to note the similarity of the organization structure under the two systems. The one great difference is the presence of the party functionary at each of the various executive levels, to make certain that all decisions are made in conformity with the owners' (the party's) policies and interests. By our standards, this would be considered interference of the worst order. However, the author explains this surprising collaboration by pointing out that nearly all managers, high and low, are party members. This means that they are presumably in full accord with the party's aims and philosophy.

Dr. Granick gives us a thorough look at the Russian manager's background, training and performance. The proletariat has been expanded, he says, to include managers and artists, and to bring them under the tent of respectability. Despite all the pious lip service to "equality," there seems abundant evidence of increasing recognition that "some people are more equal than others." Statistical evidence is cited to show an amazing similarity in the pattern of class mobility—U.S.S.R. versus U.S. So perhaps we needn't hide in shame after all when we're charged with "class rigidity." Nature seems to have a way of reasserting itself despite ideological pressures. Or, as the author says, "Necessity in Russia, as in the U.S., seems to dictate policy."

In the much discussed field of education, the Soviet manager would seem to have the edge on us. Over 95 per cent are college graduates against 56 per cent in the United States. However, the author marshals some interesting statistics indicating that a large proportion of our enterprises managed by noncollege graduates are turning in an above-average performance. He suggests that our over-all progress would suffer if we deprived ourselves of the resourcefulness and ingenuity of our noncollege-trained managers.

Now, how about incentives? Why be a manager in the Soviet with all the worries and frustrations that always accompany executive responsibility, in addition to the perils of political pitfalls, if you end up with the same pay check as the carefree worker?

Well, regardless of what Mr. Marx may have had in mind, there are potent incentives in the Soviet today of a very high order. These include salary differentials ranging from a basic average of 800 rubles per month for the workers to a maximum of 4,000 rubles for executives and top-party functionaries. In addition, there are bonuses which can reach amounts equal to the salary payments at all levels. Conversion of these figures to dollars may be misleading since there are numerous arbitrary rates, ranging from four rubles to 10 rubles per dollar. Tax rates are very low. "Status" is a very important incentive to the Soviet citizen—as it is everywhere else. There are also other amenities, such as preferred housing allocations, use of a car, etc. Opportunity

* *Published by Doubleday & Co., Inc., Garden City, N. Y. $4.50.*

for advancement is always a spur to greater effort, e.g., to exceeding quotas. The one important incentive which is absent in the Soviet economy is the privilege of passing one's accumulations on to one's children. There is absolutely no inheritance in the Communist state. This does not mean, however, that a well-placed executive is without influence in behalf of his son. Human ambitions and frailties have apparently not abdicated in the workers' paradise!

The attaining, or preferably the exceeding, of production goals is the constant and highest aim of Soviet management and party hierarchy at all levels. It is prime basis for evaluating performance and, consequently, for the allocation of the much-sought-after bonuses. Much to the dismay of the reader of this book who happens to be a financial executive, the meeting of financial budgets is of a much lower order of importance.

Replacement of the market place by the planning commission is the very heart of the economic differences between communism and the free enterprise system. Dr. Granick is at his best in tracing the workings of this omniscient body down through the various levels of Soviet industrial operations. It is a description of bureaucracy at its ultimate. To those of us schooled in the rigors of the price economy—with all its ruthlessness and shortcomings—it seems almost a miracle that anything short of chaos could emerge. No doubt the experiment has been greatly helped by such factors as a very subservient, but innately intelligent and virile people, an intense desire to catch up, and an almost fanatic devotion to Mother Russia.

What is the likelihood of any of these factors being less potent with the passage of time? And what is the likelihood of the emergence of a more sophisticated managerial class that might gradually bring about a more rational and conservative trend in Russia's political posture on the international scene?

Dr. Granick is less hopeful for this evolution than one might expect, without benefit of his analysis. He feels the momentum of this experiment will carry it considerably further, but makes it clear that to carry on it needs peace above all else.

Summing up, the author's principal objective in this book is to make a comparison of the quality and motivations of the managerial personnel in the two countries and their respective problems, rewards and operating methods. He does this ably and thoroughly, but, after all is said and done, he gives neither side a winning score. Perhaps this is intentional. Maybe he wants us to see that any minor net advantage accruing to either side at this stage is inconsequential compared to the startling fact that Soviet industry, in such an unbelievably short space of time, is eligible for consideration in such a comparison.

The Red Executive is a readable, informative and competently written work. Since the better informed we are about our competition, the more effective our planning will be, perhaps it would be a good idea to read this book!

Principles of Engineering Economy*

By Eugene L. Grant and W. Grant Ireson

In the Preface to this completely revised fourth edition, the authors state that this "is a book about a particular type of decision-making. It explains the principles and techniques needed for making decisions about the acquisition and retirement of capital goods by industry and government."

The two fundamental points stressed throughout are (1) only prospective differences between alternatives are relevant; and (2) a proposed investment in capital goods should provide a financial return commensurate with the risk and with returns obtainable from other opportunities for the investment of limited funds.

The book is divided into three parts: Planning Economy Studies for Decision-Making; Interest—The Time Element in Economy; and Techniques for Economy Studies.

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AICPA Seeks Comment on Studies Just Begun

THE ACCOUNTING RESEARCH DIVISION of the American Institute of Certified Public Accountants is beginning an investigation of a number of topics. It is expected that the results of the research will be published as "accounting research studies" by the Director of Accounting Research, and will form the basis of formal pronouncements by the Accounting Principles Board. Anyone interested in submitting comments, suggestions, or other material for the use of the research staff is invited and urged to do so.* The projects now under way are as follows:

Basic Postulates and Broad Principles of Accounting

The report of the special committee on research program, which was approved by the Council of the American Institute in April 1959, contained the following comments on this project:

An immediate project of the accounting research staff should be a study of the basic postulates underlying accounting principles generally, and the preparation of a brief statement thereof. . . . Postulates are few in number and are the basic assumptions on which principles rest. They necessarily are derived from the economic and political environment and from the modes of thought and customs of all segments of the business community. The profession, however, should make clear its understanding and interpretation of what they are, to provide a meaningful foundation for the formulation of principles and development of rules or other guides for the application of principles in specific situations. Also, the AICPA should encourage cooperative study with other representative groups to determine that its understanding and interpretation of the postulates are valid and to provide a forum which will command sufficient respect to bring about a change in the postulates when any of them become outmoded.

There should be also a study of the broad principles of accounting, and the preparation of a reasonably condensed statement thereof, similar in scope to the statements of the American Accounting Association. The results of these, as adopted by the [Accounting Principles] Board, should serve as the foundation for the entire body of future pronouncements by AICPA on accounting matters, to which each new release should be related.

This project will be under the direction of Professor Maurice Moonitz of the University of California at Berkeley.

Accounting for Income Taxes

A pronouncement on this subject was made by the committee on accounting procedure in Chapter 10(b) (Income Taxes) of Accounting Research Bulletin No. 43, and recommendations on various phases of the problem were made in Chapters 9(c) (Emergency Facilities) and 15 (Unamortized Discounts . . . on Bonds Refunded) of Bulletin No. 43, and in Accounting Research Bulletins Nos. 44 and 44 Revised, and No. 51, Consolidated Financial Statements.

Particular attention will be paid to the problems of income tax allocation among accounting periods where certain transactions reported on the income tax return are reflected in an earlier or later period on the financial statements. The study will include the treatment of loss years, allocation among sections of the financial statements, the handling of net operating loss carryback and carryforward adjustments, and other related problems.

This project will be under the specific direction of Professor Homer A. Black of Florida State University.

Accounting for Leases

A pronouncement on this subject was made by the committee on accounting procedure in Chapter 14 of Accounting Research Bulletin No. 43. Disclosure of Long-term Leases in Financial Statements of Lessees, and the provisions of this bulletin will be reviewed as a part of the new study.

Particular attention will be paid to the problems associated with the increased use of equipment leases and of sale-and-lease-back arrangements, and to the possibility of capitalizing future rental payments for financial statement purposes. The matter will be considered from the standpoints of both the lessee and the lessor.

This project will be under the specific direction of Professor John H. Myers of Northwestern University.

Business Combinations

A pronouncement on this subject was made by the committee on accounting procedure in Accounting Research Bulletin No. 48 and the provisions of this bulletin will be reviewed as a part of the new study.

Particular attention will be paid to the "pooling-of-interests" approach to the problem and a survey will be made of the experience with this type of combination in recent years.

This project will be under the specific direction of Professor Arthur R. Wyatt of the University of Illinois.

* Advance notice of the intent to participate in the projects in this way will be appreciated. All correspondence relating to the studies should be addressed to Perry Mason, acting director of Accounting Research, American Institute of Certified Public Accountants, 270 Madison Avenue, New York 16, N. Y.

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LONG SHOTS & CLOSEUPS WITH THE CONTROLLER CAMERA

Bridgeport, Conn. (LEFT ABOVE)

One of the highlights of the Bridgeport Control's Education Night, held March 2, 1960, was the presentation of 1958 and 1959 bound volumes of THE CONTROLLER to the Bridgeport University Library and a subscription to the magazine for the current year.

Shown *(left to right)* are Fred C. Thormann, president of the Bridgeport Control and comptroller of the Conde Nast Publications, Inc.; Francis DiLeo, chairman of Accounting, Bridgeport University; and John Allison, chairman of the Bridgeport Control's Education Committee and assistant treasurer of the Conde Nast Publications, Inc.

Ft. Lauderdale, Florida

(LOWER RIGHT)

Paul J. Urquhart, retired vice president of Aluminum Company of America, was honored on the occasion of his 80th birthday recently while wintering in Florida. He was the guest of a group of friends and past business associates at a birthday party in the home of his daughter, Mrs. R. A. Deemer.

Among those present to honor Mr. Urquhart, who served as president of Controllers Institute, 1936-37, were *(left to right):*

W. C. Missimer, Boutwell Dairy, Lake Worth, Florida; Vincent C. Ross, Prentice-Hall Inc., New York, and president of CIA, 1950-51; Mr. Urquhart; C. T. Zinsmeister, United Engineering & Foundry Co., Pittsburgh, Pa.; and Charles E. Headlee, retired controller, Westinghouse Electric Corporation, Pittsburgh, Pa.

New York, N.Y. (RIGHT ABOVE)

Program plans for a panel session on "Return on Investment" are reviewed by the speakers to insure coordination of topics. Pictured are *(left to right)* Thornton Smith, controller for Financial Analysis, Johns-Manville Company; W. Joseph Littlefield, research director, Controllers Institute Research Foundation; and Wilson Seney, senior consultant, McKinsey & Company, New York. The fourth panel participant, Frank S. Capon, treasurer, Du Pont Company of Canada, was unable to attend this planning session.

The panel is scheduled as one of several concurrent sessions to be held at the Eastern Regional Conference, sponsored by the Newark Control of Controllers Institute, to be held at Pocono Manor, Pa., May 8-10.

Detroit, Michigan (CENTER RIGHT)

The presidents of two major professional organizations attended a "How Much Taxation Shall We Stand?" meeting at the Economic Club held on March 21. *Left to right* are Roger A. Yoder, president, Controllers Institute of America; J. S. Seidman, president, American Institute of Certified Public Accountants; and Allen B. Crow, president, Economic Club of Detroit. Mr. Seidman was the guest speaker and his subject was "Are We in for a Federal Tax Revolution?"

Sales-Oriented Overhead Costing *(Continued from page 217)*

per se. The same cannot be said of the absorption costing concept[5] or of the direct costing[6] concept.

In the second place, sales-oriented overhead costing permits a proper understanding of the cost-volume-profit relationship. It suggests (1) that costs are incurred with a view toward reaching or servicing a certain sales level, (2) that a certain sales level must be reached in order to fully recoup the costs incurred, and (3) that profit potential is not fully realized until such sales level is reached and surpassed. This approach is not only consistent with management's planning and budgeting process, it is also more positive[7] and informative[8] than direct costing, and more realistic[9] and understandable[10] than absorption costing.

In the third place, sales-oriented overhead costing facilitates gross margin analysis and short-term sales planning. Gross margin analysis under absorption costing is difficult to interpret because of inventory transfers; such an analysis cannot be attempted under direct costing because of insufficient data.[11] Under sales-oriented overhead costing, the percentage markup remains unchanged until the expected sales level is reached; the widening of markup percentage suggests that actual sales have surpassed that level. It signals comfortable returns from that point on and permits some reconsideration in pricing policy for that short term. The same cannot be said of the other two costing concepts.

Finally, under sales-oriented overhead costing (in this instance, as well as under direct costing), changes in inventory position are to be considered solely on their financial merits, since net income will in no way be affected by inventory policy. Under absorption costing, changes in inventory position have a definite bearing upon net income and tend to exaggerate the impact of cyclical movements.[12]

SUMMARY

In a sales-oriented economy, absorption costing, a concept developed when production and productive capacity were considered the most important, is obsolete. In this paper, the writer attempts to propose a new concept, the sales-oriented overhead costing concept. In terms of theoretical considerations, the proposal seems sound based on the "cost transferability" criterion. In terms of managerial considerations, the proposal is consistent with the managerial approach to planning and analysis and compatible with managerial thinking in a sales-oriented economy.

---

[5] Brummet recognizes the shortcomings of using capacity as a basis for both planning and costing purposes: "Suppose that [a new] machine . . . will produce 156,000 units a year. The needs for this particular part or product to be produced by the new machine at the present time, and as far as can be foreseen, will average about 78,000 units per year. In the light of these data the machine is purchased. The question now is: *Assuming production needs prove to be as anticipated, should all the depreciation of the machine be associated with products or should only one-half of it be associated as a result of a 50 per cent utilization of the equipment?*"

After illustrating another situation relative to choosing between alternative purchases of equipment with different capacities that resulted in misleading inferences, he concludes that "a *planned or anticipated* utilization of fixed cost factors at the time of acquisition provides a more appropriate base for use in the assignment of costs than does the practical capacity concept." Both the practical capacity and planned utilization concepts are but two bases of assigning overhead costs under absorption costing. He reaches the above conclusion despite his understanding that the planned utilization base will result in a wider fluctuation of net income in periods of inventory changes. R. Lee Brummet, *Overhead Costing: The Costing of Manufactured Products*, Michigan Business Studies, Vol. XIII, No. 2 (Ann Arbor: University of Michigan, 1957), pp. 65-66, 67, 42.

[6] Under direct costing, neither expected sales level nor productive capacity is considered.

[7] Under direct costing, "fixed expense [is looked upon] as a cost of being ready to do business," Charles R. Fay, "Direct Costing as a Multiple-Purpose Management Tool," *Accounting, Auditing and Taxes* (New York: American Institute of Accountants, 1953), quoted in George Gibbs, "New Cost Accounting Concepts," *The Accounting Review*, January 1958, p. 98.

[8] Cf. J. M. Pompan, "Direct and Absorption Costing in One System," NAA *Bulletin*, March 1959, p. 8: "The concept of volume variance does not appear in direct costing and to its partisans this is a great step forward. One is left, however, without a measure of the effectiveness of equipment utilization, which is one of the functions performed by volume variance." Under sales-oriented costing, unabsorbed overhead costs measure the extent of sales deficiency.

[9] Under absorption costing, transferring part of fixed overhead to inventory is sometimes known as "selling overhead to inventory."

[10] Cf. National Association of Cost Accountants, *op. cit.*, p. 37: "In evaluating the effect which changes in sales volume have on profits when using absorption costing, management must consider the two influences, production volume and sales volume, which may work together or in opposition. Full understanding of the situation calls for knowledge of highly technical accounting procedures which few executives possess."

[11] Under direct costing, only variable costs are deducted from sales revenue, resulting in a figure known as "marginal income," from which fixed overhead costs *in toto* along with selling and administrative expenses are deducted.

[12] In general, under absorption costing, the higher the inventory accumulation, the higher the net income becomes, since more and more overhead will be "sold to inventory," resulting in an "overabsorbed overhead"—a fictitious figure, though recognized as income. Conversely, the deeper the inventory liquidation, the lower the net income becomes. Inventory tends to be accumulated in periods of good business and liquidated in poor years. As such, net income in a period of good business is exaggerated by the amount of overabsorbed overhead; in a period of poor business, adversely affected by the amount of overhead identified with inventory being liquidated. See George H. Sorter, "Reported Income and Inventory Change," *Journal of Business*, January 1959, pp. 47-51.

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Investment Clubs Double in Less Than Three Years

The investment club movement is growing at an extraordinary rate, according to a survey by the New York Stock Exchange. Highlights of the study, which covered the period between June 1957 and November 1959, include:

The number of clubs have more than doubled—from 8,100 to 20,100.

Membership in the clubs jumped from 121,000 to 277,000.

Volume of stocks held has tripled—from $54 million to $160 million. Average monthly investment per member was around $18.50.

The survey, based on questionnaires sent to 500 member firms doing business with the public, also noted that, as a rule, any profits and dividends are reinvested. Other findings show that:

Investment clubs have become more and more popular among women. All-female clubs added up to 10.1 per cent of the total, and the number of women members in these clubs increased from 6,507 to 28,254.

Total monthly investment for all clubs jumped to $5.1 million from $2.1 million.

Average monthly investment per club was $208; more than three quarters of the clubs invested less than $300 monthly.

In November 1959, the average club had 14 members compared with 15 in June 1957.

The average club had stockholdings worth $3,450 in eight issues. About 83 per cent had holdings of up to $10,000. Some 16 per cent had holdings ranging from $10,000 to $99,999. Three-tenths of one per cent had portfolios worth $100,000 or more.

Clubs are located in all 50 states, plus 36 in Canada and 26 in other countries. New York State led all others with 2,425 clubs, up from 776 in 1957.

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For what it's worth...

How fixed are "fixed" assets?

from the Clients' Service Bulletin of The American Appraisal Company

The mere mention of the term "current assets" brings to mind such items as cash, inventories, and accounts receivable. These assets are considered short-lived, mobile and changeable; yet, during their comparatively short life, an accurate account is kept of each item until it clears through the records.

Trend to relocation

Can "fixed" assets—the plant itself, buildings and equipment—go through a metamorphosis and emerge as assets necessitating similar financial control? By time-honored precedents, manufacturing facilities have, until recently at least, been designated as "fixed" with all the permanency, long life and immobility that the word implies.

In recent years many plants have relocated to take advantage of more favorable sources of raw materials, better transportation, available labor and nearness of markets. Existing equipment is also subject to accelerated obsolescence, abandonment, changes in use, reconstruction or replacement. Are such assets "fixed" in view of the existing trends to improvement or change?

Properties "on the move"

With the possible exception of land, "fixed" assets are not fixed in the sense that they are permanent. Some future event or decision of management may cause the continued use of the "fixed" assets to be terminated more quickly than anticipated because of sale, abandonment or obsolescence.

In this era when plant properties —often the largest item on the balance sheet—can be said to be on the move, it is desirable to provide for their control and accounting as effectively as for current assets. This is possible through basic unit property records kept constantly up to date to reflect changes that have actually taken place or that may be contemplated by management.

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Consultants—When should they be used?
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Records inventory—What information is needed and how is it compiled?
Appraisal and analysis—What standards should be followed?
Vital records—What are they and what special steps should be taken?
Microfilming—When is it cheaper than storage?
Storage—What type of equipment is best?

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Volume 1 contains 242 pages with 27 sections and the detailed index permits immediate pinpointing of hundreds of specific records retention requirements such as accounts receivables and payables, bank deposits, cancelled checks, depreciation reserves, financial reports, insurance records, journals, payroll records, tax records, and much more.

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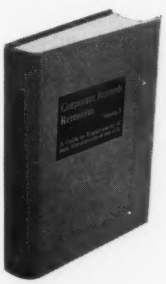

Corporate managements wishing to comply with government requirements for records retention are faced with a bewildering variety of statutes and regulations which are ambiguous, indeterminate or silent on the specific kinds of records which a business must keep, the period for which they must be retained, or both. What is reasonable and realistic is difficult to determine without, at least, reference to requirements of regulations applied to similar companies or classes of records by other governmental units.

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Taxation—Record-keeping requirements (direct or implied) in the various tax laws and regulations promulgated under these laws. Included are alcoholic beverage, cigarette and tobacco, corporate income, franchise, gasoline and motor fuel, sales and use, petroleum severance, stock transfer, highway use taxes, etc. Also included are references to statutory limitations on time within which refunds may be claimed.

Labor—Statutory and regulatory requirements pertaining to retention of records respecting employers' liability, employment of women and children, minimum wage standards, public works contractors, unemployment insurance, and workmen's compensation.

Industries—Includes statutes and regulations regarding record-keeping requirements in those industries—banking, insurance, and utilities—whose business activities are closely associated with all industries and, therefore, of interest to all companies.

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Research Notes

Who Is Responsible for the Annual Convention Statement?

Six of nine insurance companies questioned by Controllers Institute Research Foundation reported the controller has the prime responsibility for preparing the annual statement. In each of these companies, the controller signs the certification on page one of the statement (in one case, the treasurer also signs) and the controller's department has the responsibility for actually assembling the statement.

The survey to determine which corporate officer has the responsibility for preparing, signing and assembling the annual convention statement, found that in two other companies the chief actuary has the prime responsibility for preparation and assembly but, in one of these cases, the controller signs it.

The remaining company questioned reported both the controller and chief actuary share the responsibility for preparing and assembling the statement, but the vice president and treasurer and the controller sign it.

While one department generally has the prime responsibility for actually assembling the statement, parts of it are often prepared by other departments in the representative companies surveyed.

The Organization Man: A Rebuttal

The "organization man" is not the plodding conformist of recent fame, says Opinion Research Corporation after it interviewed top officers in 12 different industries and surveyed some 600 middle-management men. "Presidents and middle management agree the corporation rewards the man of daring and initiative, not the conformist. . . ." Some companies show strong signs of conformity but these are the exceptions, concludes the report.

Suggestions for Better Campus Recruiting

The following suggestions for more effective recruiting on campus by company representatives were gleaned from college placement officers in an American Management Association survey:

Recruiters should spend more time discussing a candidate's interests and qualifications and less time on information about the company that can be presented in written form.

Recruiting literature could be improved by including specific job descriptions rather than generalizations and "glamorizing."

If recruiters are not interested in students with less than a "B" average, they should say so.

Students should be told what the beginning job will be like so they will not feel "railroaded" when they are assigned menial tasks.

Placement officers at liberal arts colleges added a few points on the neglect of the broadly trained liberal arts student who doesn't fit neatly into a pattern.

Depreciation at Home and Abroad

U. S. tax officials still think in terms of the longest physical life of equipment, instead of the shorter, economically useful life, reports Joel Barlow in a recent issue of *Mill and Factory*. In contrast to this, West Germany has a ten-year depreciation period on industrial machinery, but 60 per cent may be charged off in the first two years.

In Sweden, machinery can be fully depreciated in five years; in Italy in seven years, with special adjustments for the effect of inflation. In Holland there is a ten-year write-off, with accelerated rates in the earlier years, also an investment allowance is made to allow deductions of more than 100 per cent of costs.

An initial allowance in Britain allows the manufacturer to write off 30 per cent of the cost of machine tools and similar productive equipment in the year of acquisition.

Vacation Benefits Up in 1960

Increased vacation allowances are in line for many firms for 1960, according to a Darnell survey of 300 United States and Canadian firms. Major trends include longer vacations, greater acceptance of split vacations, and a growing tendency for firms to extend vacation periods over the entire year. Plant shutdowns during a general vacation period are losing ground, with only 23 per cent of firms queried planning a shutdown period for

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1960, as compared with 43 per cent of a similar group in 1954.

Two complementary reasons behind this liberalization, according to the editors of the survey, are the changing vacation habits of the American people and the tight labor market that most firms anticipate in the years ahead.

This Electronic World

A new general-purpose electronic computer, Monrobot Mark XI, has been announced by Monroe Calculating Machine Company, a division of Litton Industries. The computer will be priced at $24,500, weighs 300 pounds, is fully transistorized, operates from any AC wall outlet, and requires no air conditioning.

•

The National Cash Register Company announced plans for a nationwide network of data-processing centers. Three centers will be opened this year—one in New York, another in Los Angeles, and a third in Dayton. They will utilize the new transistorized NCR 304 data-processing system and will operate seven days a week on a round-the-clock basis.

•

A new electronic data-processing system for business, scientific and industrial use has been introduced by Bendix Aviation Corporation. Designated the G-20, it is smaller than most large-scaled systems; the central processor is 66 inches wide, 60 inches high and 28 inches deep. It is built of solid state components and has an expandable random access core memory.

•

The Datamatic Division of Minneapolis-Honeywell has moved into the moderate-price computer field with the announcement of the new all-transistor Honeywell 400. The basic 400 model with a central processor, four high-speed magnetic tape units, a high-speed printer and a card reader will rent for $8,660 a month. It will be available in the summer of 1961 and will be compatible with Datamatic's larger Honeywell 800.

•

Sabre, the completely automatic, centralized, electronic reservations system, will handle all functions and procedures associated with the sale, confirmation, and control of an air travel reservation, for American Airlines, from the time a customer calls for information on a flight to the time he arrives at his final destination. Installation of Sabre, which has been designated the IBM 9090 by the manufacturer, will begin in 1961.

•

No claims for divinity have been made, but a new automatic programming system has been named BLESSED 220. Produced by the cooperative efforts of Michigan Bell Telephone Company; Arthur D. Little, Inc.; and Burroughs/ElectroData, the name is derived from the initial letters—Bell Little ElectroData Symbolic System for the ElectroData 220 computer.

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PROGRAM HIGHLIGHTS

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What the Educator Expects of Industry

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How Can We Help Keep the Incompetent Out of Industry?

TRAINING OF THE MAN—

Men vs. Machines: The Impact of IDP and EDP on the Training of Men

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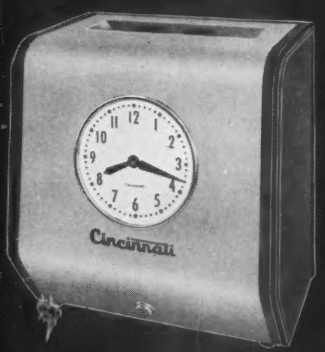

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ADDITIONAL DUTIES . . .

Railway Express Agency, Inc., New York, has made **Robert A. Sauer** vice president and controller. . . . **Walter J. Short** has become secretary and vice president-finance of Allegheny Airlines, Inc., Washington, D. C. . . . **Lisle W. Adkins** has been elected vice president and controller of General Dynamics Corp., New York. He is a past president of the Cincinnati Control of Controllers Institute and has served as an Institute director. . . . **Wagner J. D'Alessio** has assumed the responsibilities of vice president and treasurer of Index Underwriters, Inc., San Francisco, Calif. He is a past president of the San Francisco Control, Controllers Institute.

Paul W. Heasley has been elected president of Trailmobile International, Inc. He will continue his present duties as vice president of the parent company, Trailmobile, Inc., Cleveland, Ohio. . . . Raytheon Company, Waltham, Mass., has elected **George Ingram, Jr.,** vice president and controller. . . . **George J. Zimmerman** has assumed the responsibilities of vice president and controller of the Carborundum Co., Niagara Falls, N. Y.

NEW APPOINTMENTS . . .

Julius Yetka has joined the corporate staff of Pfaudler Permutit, Inc., New York. . . . **John W. Morrison** recently became general manager of the Missile Equipment Division, Minneapolis-Honeywell Regulator Co., Pottstown, Pa. . . . **Franklin R. Ehmann** is now treasurer of the Hellwig Dyeing Corporation, Philadelphia, Pa. . . . **Raymond D. Balcolm,** Forbes Lithograph Mfg. Co., Boston, Mass., was recently elected a director as well as vice president in charge of manufacturing. . . . **Lawrence D. Brumit** was elected vice president and controller of the Florida Power Corporation, St. Petersburg, Fla.

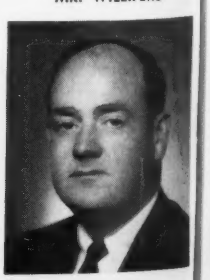
PROMOTIONS . . .

Edward G. Sommer has assumed the responsibilities of treasurer of Standard Oil Co., Inc. in Kentucky, Louisville, Ky. Mr. Sommer is a past president of the Louisville Control of Controllers Institute. . . . **William H. Van Beck** became vice president of the Nitrogen Division of Allied Chemical Corporation, New York. . . . The election of **Harold E. Williams** as vice president and a director

MR. INGRAM

MR. ZIMMERMAN

MR. WILLIAMS



of American Thread Company, New York, occurred recently. . . . **Arthur M. Wood** was named comptroller of Sears, Roebuck & Co., Chicago, Ill.

Verne B. Bonnette has been made vice president of Schmidt Lithograph Company, San Francisco, Calif. . . . The election of **Emerson G. Higdon** as executive vice president and treasurer of the Maytag Company, Newton, Iowa, was announced recently. . . . **Nelson T. Hampson** is now vice president-finance of Lowe Paper Company, Ridgefield, N. J. Mr. Hampson is a past president of the New York City Control of Controllers Institute and served as an Institute director.

Carl W. Janke will become controller of Harvard University on July 1. Formerly deputy controller, he succeeds **L. Gard Wiggins,** who becomes administrative vice president. . . . J. A. Folger & Company, Kansas City, Mo., has named **J. Lowell Johnson** as treasurer. He is a past president of the Kansas City Control of Controllers Institute. . . . **Garrett E. Kauffman** has been appointed assistant controller of Armco Steel Corporation, Middletown, Ohio.

The election of **William C. Knapp** as vice president-finance and accounting of the Arundel Corporation, Baltimore, Md., was announced recently. He is a past president of the Baltimore Control of Controllers Institute. **C. Edgar Fishel** succeeds Mr. Knapp as controller of the corporation. . . . **Paul C. Major** was elected comptroller of Birmingham Southern Railroad Company, Fairfield, Ala., and was elected to the board of Warrier and Gulf Navigation Company and Ohio Barge Line, Incorporated. . . . **John P. O'Keefe** recently became general manager of the Utah Copper Division, Kennecott Copper Corporation, Salt Lake City, Utah.

NEW DIRECTORS . . .

William H. Campbell, treasurer and assistant secretary, the Elwell-Parker Electric Company, Cleveland, Ohio. . . . **Ellis M. Moore,** vice president-finance, the F. & M. Schaefer Brewing Co., Brooklyn, N. Y. . . . **Alfred G. Nelson,** vice president and treasurer, Compo Shoe Machinery Corporation, Boston, Mass. . . . **Gordon A. O'Brien,** treasurer, Worcester Telegram Publishing Co., Worcester, Mass. . . . **J. Shirley Gracey** and **H. K. McKean,** senior vice presidents, Florida Power Corporation, St. Petersburg, Fla.

NEW CONNECTIONS . . .

Glenn E. Robe recently became comptroller of the Marietta Manufacturing Company, Point Pleasant, West Va. . . . **C. H. Bentzel** has joined Leaf Brands, Inc., Chicago, Ill., as controller. . . . **W. P. Gullander** has become executive

(Continued on page 250)

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THURSDAY, JUNE 16

10:00 a.m.	AREA OPERATIONS COMMITTEE MEETING.
12:30 p.m.	DUTCH TREAT LUNCHEON.
2:00 p.m.	CONTROL ADMINISTRATION ROUND TABLE.
5:30-7:30 p.m.	REGISTRATION AND RECEPTION.

FRIDAY, JUNE 17

9:30 a.m.	CONFERENCE KEYNOTE by General Chairman Frank S. Capon, Treasurer, Du Pont of Canada Limited, Montreal.
	TECHNICAL SESSION Chairman, Kenneth M. Place, First Asst. Treas., Du Pont of Canada Limited, Montreal.
	COMMUNICATIONS IN BUSINESS. Thomas W. Eadie, President and Chairman, The Bell Telephone Company of Canada, Montreal.
11:00 a.m.	FINANCIAL COMMUNICATIONS. W. S. Rothwell, Vice-President & Treasurer, Abitibi Power & Paper Company, Limited, Toronto.
12:30 p.m.	LUNCHEON: Chairman, E. L. Hamilton, Vice President, Canadian Industries Limited, Montreal.
	SPEAKER: A. T. Lambert, Vice President and General Manager, The Toronto-Dominion Bank, Toronto.
2:00 p.m.	SMALL GROUP DISCUSSIONS. I Annual Report. II Financial Statements for Management. III Forecasts and Budgets. IV Capital Forecasts. V Control Reports—Manufacturing Costs. VI Control Reports—Selling & Administrative Expenses. VII Information for Union Negotiations. VIII S.E.C. Statements. IX Corporate Giving. X Financial Communications between Parent and Foreign Subsidiary.
7:30 p.m.	BANQUET AND ENTERTAINMENT.

SATURDAY, JUNE 18

9:30 a.m.	PROBLEMS OF FINANCIAL COMMUNICATIONS. I. Large Companies: *Chairman,* B. A. Johnson, Treasurer, New England Gas and Electric Assn., Cambridge, Mass. K. Y. Siddall, Administrative Vice President, The Procter and Gamble Company, Cincinnati, Ohio. II. Medium and Small Companies: *Chairman,* Harold L. Gebike, Secretary-Treasurer, Electro Refractories & Abrasives Corp., Buffalo, N. Y. Robert N. Wallis, Vice President and Treasurer, Dennison Manufacturing Company, Framingham, Mass.
10:45 a.m.	PANEL DISCUSSION: I. Large Companies. II. Medium and Small Companies.
12:30 p.m.	LUNCHEON: Chairman, Frank S. Capon. SPEAKER: Hugh MacLennan, Author.

PLUS A PROGRAM OF SPECIAL EVENTS FOR THE LADIES

vice president of General Dynamics Corp., New York. . . . **Raymond J. Kenard** is district controller of the Pioneer Ice Cream Division, East District, of the Borden Company, Brooklyn, N. Y. . . . **J. W. McDonald** became treasurer and assistant vice president-finance of W. A. Sheaffer Pen Company, Fort Madison, Iowa. . . . **C. E. Nelson** recently became controller of Stowe-Woodward, Inc., Newton Upper Falls, Mass.

Thomas J. Rowe recently became vice president-finance and treasurer of Knox Glass, Inc., Knox, Pa. . . . **Cecil E. Vancil** is vice president of the Electric Autolite Company, Toledo, Ohio. . . . **Rolfe Wyer** is now vice president and treasurer of Airtek Dynamics, Inc., Compton, Calif. . . . **Murray S. Gelber,** Los Angeles, Calif., has become chairman of the Board of Harvill Corporation, as well as a member of the Board of both Durox of Southern California Inc., and Salsbury Corporation. Mr. Gelber is currently serving as vice president of the Western Area of Controllers Institute.

COMPANY CHANGES . . .

O. P. Thomas was elected executive vice president and a director of Sinclair Oil Corporation, New York. He succeeds **Harry Jeffries** who is retiring but continues as a director and chairman of the Finance Committee. . . . **Edward W. Jamison** has been elected vice president and director of finance of General Time Corp., New York; he will continue also as company secretary. **G. G. Ellis** has been elected treasurer.

EXTRACURRICULAR ACTIVITIES . . .

Harold F. Stevens, controller, St. Regis Paper Company, New York, is chairman of the Controllers Committee of the

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American Pulp and Paper Association. . . . **Steve H. Bomar,** senior vice president and secretary-treasurer of the Trust Company of Georgia, Atlanta, Ga., has been elected president of the Atlanta Clearing House Association. . . . **Robert M. Tracy,** treasurer and controller of the National Life Insurance Company, Montpelier, Vt., was elected a trustee of the University of Vermont for a three-year term. . . . **Robert B. Curry,** comptroller, Southern Railway Co., Washington, D. C., was elected first vice president of the Society for Advancement of Management.

AUTHORS . . .

Arnold W. Johnson, chairman, Department of Accounting, New York University, is the author of *Advanced Accounting* published by Rinehard & Company, Inc., New York. . . . **Hans C. Todt,** comptroller Bristol Laboratories Inc., Syracuse, N. Y., authored an article in the February 1960 issue of *Credit and Finance Magazine* entitled "Accounting Reports—a Management Tool" as well as one on "Internal Auditing—A Service to Management" which appeared in the March 1960 issue of the *Internal Auditor.*

SPEAKERS . . .

On the program of the Annual National Conference of the National Society for Business Budgeting to be held May 19-20 at the Netherland Hilton Hotel, Cincinnati, Ohio, are: **E. W. Buge,** controller, Bernardin Bottle Cap Company, Inc., Evansville, Ind., whose subject will be "Practical Electronic Data Processing" and **Wm. H. Zimmer,** executive vice president and treasurer, the Cincinnati Gas & Electric Company, Cincinnati, Ohio, who will speak on "Planning and Financing Long-Range Capital Expenditures." . . . **N. J. Brown,** vice president and comptroller, the Steel Company of Canada, Ltd., Montreal, Quebec, Canada, will be a speaker on the subject of "Developing a Systems and Procedures Programme-Larger Office" at NOMA's 41st International Conference and Office Exposition to be held at the Queen Elizabeth Hotel, Montreal, May 22-25.

PICTURED BELOW

Students from the University of Colorado and the University of Denver were guests of the Rocky Mountain Control of Controllers Institute recently. Speaking at the meeting in Denver were **Edward F. Dolansky,** controller with the Heiland Division of Minneapolis Honeywell Regulator Co., and **Roland W. Prickett,** assistant treasurer with Stearns-Roger Manufacturing Co. Both discussed the duties of a controller. The students were members of a class in industrial accounting at the University of Denver taught by **Professor Wayne Shroyer** and of a class in controllership at the University of Colorado taught by **Dr. Robert S. Wasley.**

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Policy Changes Recommended to Alleviate Balance of Payments Problem

THE SIZE AND CHARACTER of United States' deficits in its balance of payments with other countries demand policy changes here and abroad to reduce the outflow of gold and dollars which amounted to $3.5 billion to $4 billion a year in the last two years.

In a recent statement, the Research and Policy Committee of the Committee for Economic Development said that, because of our current strong economic and financial position and the absence of any immediate danger, the United States has the time and opportunity to select and put in practice a solution to the balance of payments problem that lies "not in the direction of restraints on imports or upon U.S. foreign investment and assistance but in the expansion of our exports of goods and services."

As the Committee pointed out, the problem is not that the United States is becoming poorer (actually, our assets abroad have increased), but that we can be required to settle our debts in gold of which we have a limited—even though large—amount.

Among recommendations for action in the statement, "National Objectives and the Balance of Payments Problem," are:

1. Increasing the competitive "attractiveness of American goods and services in world markets" mainly through the Government's domestic economic policies and the actions of business and labor. "A strong anti-inflationary fiscal, monetary and debt-management policy at home is the first requirement."

2. Reduction or elimination of restrictions on purchases of Unted States goods, and travel and investment in the United States. Direct and indirect restrictions "are no longer justifiable and should be removed in keeping with the provisions of the Articles of Agreement of the International Monetary Fund and the General Agreement on Tariffs and Trade."

3. The United States foreign aid program "should not be determined by our balance of payments position. . . . It is the task of economic policy to maintain a balance of payments position strong enough to support these important programs." At the same time, the Committee observed that the rising national incomes of other countries make it appropriate for them to share to a larger extent the "common burdens of defense and economic assistance."

Expanding on the first recommendation, the Committee stressed the importance of a rigorous domestic anti-inflationary policy to strengthen the competitive position of American products. Despite the encouraging use of fiscal, monetary and debt management instruments recently, the statement warned of three causes for concern in the field of financial policy:

1. Whether we have "the fiscal responsibility to generate substantial (budget) surpluses when they are required."
2. Whether the "logic of flexible monetary and debt management policies is sufficiently understood to permit an adequate degree of restraint at all times."
3. Whether we follow "prudent continuing policies to prevent dissipation of reserves and regain reserves when the temporary occasion for disbursing them has passed."

However, this policy alone will not be sufficient; American business and labor, particularly in those industries involved in foreign trade, must realize that the degree of foreign trade we now face is new to us and must be met with vigorous action to insure that labor costs and prices will not eliminate our products in a competitive world market.

Other areas for corrective action include the Government's role which, up to now, has been too exclusively geared to the domestic situation "as if we lived in isolation from the world economy." In support of this contention, the United States' agricultural policy was cited as "probably the major obstacle . . . to increased American earnings abroad," scoring, in particular, the high price support policy and acquiescence to world-wide barriers to international trade in agricultural products.

This statement does not consider the important general question of the "long-run adequacy of the existing system for maintaining equilibrium among the national economies of the world." This will be discussed in a later CED statement which will supplement and may modify the views expressed in the current statement.

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SITUATIONS WANTED (Continued)

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